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INDIAN BANKING AND CURRENCY PROBLEMS

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PREFACE

This symposium intends to throw light on some of the leading problems of Indian banking and currency with which this country is faced. The contributors are authorities in the subjects on which they have made the contributions which form this symposium; and we trust this group study will help a clearer and better understanding of some of the very intricate issues, which require attention.

Contributions on certain important subjects had to be left out due to one reason or the other. We are specially sorry to have to omit Dr. Gyan Chand's illuminating contribution on *Reserve Bank in Action* and Sir Chunilal B. Mehta's thought-provoking contribution on *Inflation and Currency Problems,* besides several others. As the publication of this symposium has already been considerably delayed, it was thought advisable to publish it immediately, even without these contributions.

We hope this group study of our banking and currency problems by India's leading experts—both economists and practical bankers—will succeed in accomplishing the object which it intends to serve.

EDITORS

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THE FUTURE OF FOREIGN CAPITAL

BY

Nalini R. Sarker

The needs of post-war reconstruction in devastated or undeveloped countries, which lack the resources necessary for undertaking the task and accomplishing it with reasonable expenditure, has brought the question of foreign capital to the fore. The subject is indeed as old as Economics and both as a problem of economic theory and as a practical issue of economic policy, its pros and cons have been widely and almost exhaustively discussed. The present setting of world conditions in which the conflict of economic interests between advanced and backward countries may be said to have become less sharp, calls for a reorientation of the traditional outlook on this problem.

Rationale of International Investment

It is an economic trusim that capital, combined with skill and enterprise, is essential for the development of a country's economic potentialities,, and for securing higher income-levels and higher standards of welfare for its inhabitants. But the distribution of capital over the countries of the world is still very unequal. At the same time, scope for development or avenues of fresh investment are, by the same token, unequal. These considerations constitute the rationale of international investment which, if used along different lines and in different forms, will put the savings of the world to the most advantageous use. In the absence of the freedom of the flow of international capital, the expansion of an undeveloped country with insufficient capital accumulations may be severely limited or may be achieved by forcing severe privations on the common people. The latter was true, for example, of Soviet Russia, where the capital required for the execution of successive five-year plans was squeezed out of the standard of living of the people. Had Soviet Russia been able to obtain the assistance of foreign capital, the sufferings of her people would have been minimized, if not altogether avoided.

Apart from this consideration, an "expanding world economy", which every nation has accepted as the ideal to follow, cannot be

fully realised without a continuous flow of investment internationally. This is confirmed by the economic development of the 19th Century, as well as by the incipient trends of the evolution of world economy in future. It was in recognition of this fact that the World Bank Plan was evolved at Bretton Woods as an adjunct to the Monetary Fund to facilitate the flow of international capital. Such flow of international funds not only helps the borrowing but also the lending countries. This may be illustrated with reference to the U. S. A., the No. 1 creditor nation of the world. As the U. S. A. is a fully developed and mature country, an enormous volume of savings is effected with hardly any privation worth the mention. Not all these savings, however, can be utilised at home without leading to a sharp fall in the marginal efficiency of capital, which is already tending downwards due to the congestion of the internal investment market in the U. S. A. With a population that has almost ceased to grow and internal development reaching a high level, the scope for the profitable utilisation of expanding American capital within the country must soon begin to fade altogether. The American investors must then seek a higher return by lending abroad rather than investing at home. This is not only a question of a higher return for individual investors. With it is bound up the question of maintaining full employment at home, since investors not earning a fair and reasonable return on their capital will be compelled to restrict their volume of output with consequent unemployment for many.

Drawbacks of Foreign Lending

In an economic analysis, it is however well to point out certain drawbacks of foreign lending. From the standpoint of the creditor country, it can become a danger if a nation is too dependent upon its income from investments abroad. A great war or any political crisis that shakes a continent can disturb to its roots an economic structure that rests on such a foundation. Britain has been reduced to this plight by the war that has recently ended. But the more serious defects of foreign lending emerge from the point of view of the debtor. Apart from the fact that a certain proportion of the profits naturally go out of the country year by year, the vested interests created by external capital have a tendency to acquire political influence in the debtor country, which is usually exercised for

supporting the *status quo* and resisting political and social progress. This has happened in practically all the Asiatic countries with the exception of Japan. China, despite her political status, has long been the battle-ground of foreign capital from the major countries. Malaya, Thailand and Indonesia have h d to pay for their foreign loans with their political freedom. Similarly in India and Burma, foreign capital has brought within its grip many an indigenous industry. Consequently, foreign capital in these areas has created not a little bitterness among the people, which has naturally reacted adversely in the political sphere, the more so because the expectations and yields of such investments were generally among the highest for comparable risks in any part of the world.

Foreign Capital and National Political Status

It should be remembered, however, that generally speaking foreign capital has obtained control of industries in countries which have a subordinate political status, while in free countries control has to be less direct or open. The principal areas to which foreign capital has hitherto flowed are the European countries, the British Dominions and Colonies, the South East Asiatic countries and the Republics of Latin America. Most of the countries in the three latter groups are primary producers with a dependent political status, while the countries in the first category, namely those in Europe, besides enjoying sovereign political status, are not primarily producers of raw materials and foodstffus for export. Foreign investment in these latter countries has not led to the creation of vested interests of the same kind as in countries politically dependent. It appears, therefore, that if a country could get rid of this disability and achieve full freedom and severeign power, foreign investments may be largely shorn of their baneful consequences. But instances of free countries suffering increasing foreign domination on account of the loans they had taken are not few and far between. And this explains the almost universal dread of foreign loans and investments on the part of the borrowing countries.

Foreign Capital in India : Its Magnitude

The question of foreign capital in India has to be considered against the background of both these tendencies. To start with, it should be mentioned that there is no reliable and accurate estimate of the aggregate foreign capital sunk in India. Most current estimates

are based on guesswork and many of the pre-war estimates have naturally become out of date. The divergence between any two estimates is so wide that they do not offer a dependable basis for any sound conclusions. The need for a census of foreign capital in India is imperative, from whatever point of view one looks at it; the sooner it is done by Government in collaboration with commercial bodies, the better.

An idea of the magnitude of foreign capital employed in India may be had by considering certain broad features. The total overseas investments of Great Britain in 1930 were estimated at £ 4,000 millions. In the same year, the "Economist" estimated British investments in India at £ 700 million, which is approximately 1/6th of Britain's total overseas investments. In 1933 the British Associated Chambers of Commerce estimated British investments in India at £ 1,000 millions, or roughly one quarter of Britain's total overseas investments.

Return on Existing Holdings

To-day British investments in India are considerably lower than in pre-war years partly because Burma was separated from India in 1937, but chiely because well over £ 350 million in British-held sterling obligations of the Government of India have been repatriated during the war. This leaves, on the basis already mentioned, something in the neighbourhood of £ 240 million worth of British envestments in India. This figure seems far too small in view of the position as we find it, but even if it be accepted, it is by no means negligible and far exceeds Britain's combined investments in its Asiatic dependencies. Further, although British investments in India have been reduced, India still remains a good source of profit to England. It is very difficult to secure estimates of the total returns but, according to one British calculation, the remaining sterling debt of approximately £ 12 millions brings in £ 550,000 annually; the commercial and industrial investment of £ 240 millions yields £ 16,500,000 every year (6⅞ per cent) ; and annual pensions amount to £ 5,900,000. To this annual total of £ 22, 950,000—in itself a not inconsiderable sum—one has to add the remittances of Englishmen now employed in India and the returns on shipping and insurance services to reach anything like a correct figure. This shows that, although British investments are considerably reduced, the return on the remaining investments is by no means small or insignificant.

Distribution of Forign Holdings

One of the characteristic features of India's foreign borrowing has been the relatively large amount of external indebtedness contracted by public authorities in proportion to the total amount of forign capital employed, while capital employed in private industries amounted to about one-third of the total. Today, due to the liquidation of sterling debts, most of this public borrowing has vanished. Of the amount engaged in private industries (about £ 240 millions according to a British source) over half is employed in trading and manufacturing industries. Banking and loan companies and insurance companies together absorb rather more than one-fifth; steamship, railway, and other transport enterprises about 13 per cent. and tea plantations and mines, about 5 per cent. each.

Balance Sheet of Gains and Losses

In estimating the gains and losses arising from the employment of foreign capital in this country, one should initially recognize, as pointed out by the External Capital Committee, that British Capital has helped India in several ways not easily realised, because they do not lie on the surface. A good proportion of the capital which they invested did not become properly remunerative until after years of strenuous work and waiting. The huge profits made by British business in India are usually apparent, but the losses which they had to bear at one stage or another are generally ignored. These initial losses are inevitable when a country is first sought to be developed. And these losses the British capitalists had to bear. "But once the country is developed—as it is now—once railways and steamships are built, markets are established, demand is stimulated and created, population has increased, the labouring class is created and trained—all those who handle industries later on get the benefit of this development without being called upon to pay any price for it. Indian capital which is now for the first time financing industries has avoided all these initial costs of development." Perhaps this point of view is put in a rather extreme form, but the fact must be admitted that the fields of Indian business were cleared long ago by British capitalists. While this does not constitute any justification for further penetration by foreign capital at this stage of India's development, the point should not be lost sight of in an objective assessment of the gains and losses arising from the employment of foreign capital.

But the lossess far outweigh the gains. India's position with regard to foreign capital is very different from that of Japan's. Japan borrowed from abroad to finance her development, but retained control of such capital and her destiny in her own hands and eventually developed from a debtor to a creditor nation. But India has suffered from the disadvantage that her utilisation of foreign capital has entailed outside control over the choice of investments and hence over the general tread of economic development. Furthermore, one can easily realise that "investment has been guided by British rather than Indian interests, that profits and interests have been drained out of the country, that enterprise has been concentrated upon commercial and a few special types of industrial concerns to the neglect of broader industrial needs, that Indians have not enjoyed full opportunities for technical and managerial training and experience and that undue advantage has been taken of the cheapness and abundance of Indian manual labour." Many of these charges are doubtless true even if some of them have been expressed in a somewhat extreme form.

Future of Foreign Capital in India : The Right Perspective

In evaluating the future role of foreign capital in India, it can be laid down as a general principle, as the External Capital Committee did, that the inflow of external capital is not only unobjectionable in itself but it is a valuable factor in assisting the economic develoment of a country and in increasing its wealth and employment, *provided it does not lead to the establishment of foreign control and management over its economy*. It would, however, be even more advantageous if India's requirements of new capital were supplied from internal sources as far as possible. As the External Capital Committee has recognised, India already possesses a large store of potential capital to meet the larger share of India's industrial requirements but much of it is shy, conservative and requires to be drawn out. The real solution of the problem lies in the encouragement of the Indian investor and the mobilisation of India's internal capital resources by a more widespread development of banking services and credit facilities.

Do We Need Fereign Capital ?

Assuming that everything possible will be done to develop India's capital resources, shall we still be in need of foreign capital

as a supplementary source? This is the most vital question that suggests itself and the answer obviously would depend on India's plan for development and the total cost of the same. It is commonly assumed that foreign capital is necessary; but conditions have changed so vastly in recent years that this old assumption cannot be accepted without re-exmination. It is easy to exaggerate the capital requirements of a comparatively under-developed country like India and then go on to argue that all the capital required is not available inside and that a large part of it, therefore, will have to be borrowed from other countries. While persistent and praiseworthy efforts have been made to assess India's capital need, a like attempt has not been made to appraise the total amount of capital available for investment within the country from current savings. For the present purpose, it would be sufficient to restrict our calculations to the amount of capital that India would require within the next ten years.

India's Capacity to Use Capital

While it is necessary to know how much capital we need, it is equally important to estimate how much capital we could use every year or during a particular period of years. Our need for capital may be large but it is obviously inadvisable to borrow more than we can use efficiently and profitably at each stage. There are many limiting factors that prevent us, under the existing conditions, from properly utilising as much capital as we may need. There is, in the first place, the question of trained personnel. The amount of technical and expert assistance available in India is limited both in quality and quantity. It is possible, of course, to hire expert technical men from abroad; but even here there are obvious limitations, as every completed year of development will entail so many more men to run the factories that may have been built than will be available, apart from the men needed for the next stage of development.

The actual availability of plant and machinery from abroad is another factor that should be taken into consideration. From published reports, from impressions gathered at first hand by our own Delegations and from our recent experience, it does not seem probable that capital equipment would soon be available to India in anything like the quantities that we may need. Even if this were released, there is a limit to the number of factories we could build in a particular year in view of the extreme shortage of coal and

building materials in India, especially steel, in the aftermath of a global war. (Taking all these factors into consideration, I would put the total amount of capital that India could use in a year at Rs 300 crores, with Rs 350 crores as the most optimistic figure. I think that Rs 300 crores could be found comfortably from our own saving, especially as we have repaid a very large part of our foreign obligations and the amounts which formerly used to be remitted to England as interest and profits, are now available for internal investment.)

It is safe to assume that as the years go by, our ability to absorb capital will also increase and one can also foresee that within a reasonably short period of time, we may need to import some capital from abroad. Even if we assume for argument's sake that India could find all the capital she needs from her own resources, it may be necessary to incur foreign obligation for obtaining technical assistance, plant and machinery, the use of patent rights etc. from the countries concerned. In such special circumstances, foreign interests may insist on some share in certain types of undertaking in India, which cannot be started without highly specialised foreign technical skill and machinery and processes protected by patent rights. There appears, however, to be a dangerous tendency at work among foreign investors and specialists who wish to take advantage of India's necessity by insisting on a controlling interest in Indian eeonomy as the price of foreign capital and technical aid. In such cases of direct investment by foreign investors, we have the establishment of joint enterprises in which foreign enterpreneurs contribute a part of the capital. Generally speaking, however, direct enterpreneurial investment is likely to be preferred by foreign investors to such joint enterprises. In the latter case, there will be difficulties arising out of the fact that the different rates of interest in respect of the capital raised by foreign and national investors, may give rise to divergent business and dividend policies. Another difference may arise if the foreign investor is a large corporation with a high degree of vertical integration. It would be difficult for such an investor to find a corresponding national partner in an undeveloped country. It would thus be obliged to establish joint enterprises with different firms and this may act aa an additional deterrent to investors going in for this form of investment. However that may be, India, in view of her past experience, can never agree to

any terms which entail foreign control. Today India needs more foreign technical and managerial assistance in certain fields than foreign capital. This assistance should be made available on mutually agreed and usual business terms and as such, no question of control by foreign interests should at all arise. In some cases foreigners may of course insist on joint enterprises, which may be agreed to, provided this will not involve the debtor nation surrendering the dominating share thereof. Participation by foreign interests ranging from twenty to thirty per cent. of the capital requirements is all that need be allowed in such cases.

In Defence of Foreign Capital

The protagonists of foreign investments have, however, put forward a plausible case in defence of foreign capital when faced with the growing bitterness of colonial and backward peoples against the adverse effects of such borrowing. To begin with, the virtues of foreign capital are emphasized, particularly the benefits accruing to the borrowing countries. These countries, it is pointed out, in default of the free and fertilising flow of capital and skill would be left to their "own lack of resources" in developing their backward economic structures. This line of argument goes on to deplore the fact that the rising tide of economic nationalism in certain backward countries is used as a subterfuge to put obstacles in the path of this life-giving flow of international capital and expert.

The porblem is thus deliberately posed from the borrower's point of view in order to show that foreign capital flows into dependent areas not without a certain measure of altruistic and benevolent motives apart from its undeniable good effects. From this it is but a short step to argue that to enable such investment to flourish to the general advantage of all, certain preliminary conditions must be fulfilled. The fundamentals of such a policy for the fostering of international investment are the implementation of measures to minimise the risks especially associated with foreign investment—risks both political and commercial. The commercial risks relating to international investment are those of ordinary local or indigenous investment merely intensified in degree. The political risks. however, include disputes about control, blocking and depreciation of currency and exchange, interruption of operations, and payments by war and civil commotition, undermining of trade by tariffs and quotas, penal taxation or confiscation of property and profits. discriminatory

legislation etc. Special risks of course attach to investments which depend for their value on the continuance of a political privilege. All such political risks differ from normal commercial risks inasmuch as they do not emanate from the ordinary economic process so that their effects are imponderable. It is further claimed that nations receiving foreign capital should not impose burdensome regulations relating to its administration and the conditions of operation. In default of these minimal conditions being fulfilled it is contended that "the volume of direct investment will be smaller, investors' losses will be larger, and the costs and difficulties to the recipient country of obtaining foreign capital with technical skill will be greater than they need be." The last part of the sentence contains a veiled threat to the effect that countries in need of foreign capital will be denied the same unless these conditions are accepted, unless, that is to say, the investing countries get their own terms—their pound of flesh. To make assurance doubly sure, the conditions enumerated above are sought to be incorporated in a code of International Commercial Conduct or Fair Treatment, "guaranteeing a reasonable freedom of capital movemens, of business opeartion, of administrative control and of remitting profits." This Code is also to include provisions precluding discriminatory action against the investing country.

In all such matters a policy of give-and-take is called for, subject to the fundamental principle that the invester shall not be allowed to selfishly exploit the borrower, who in his turn shall of course not deal unfairly with foreign capital. There are certain undeniable benefits flowing from such capital, for a large part of the new stream of wealth thus created will remain in the borrowing country. It is, however, incumbent on the latter to prohibit foreign investments inimical to the national to the national interest or which seek to displace indigenous capital in existing or new ventures. The borrowing country, moreover, should seek to train its own personnel in technical lines with a view to expanding its own employment. Properly viewing the problem, therefore, certain safeguards would be adequate to protect the interests of the borrowing country as far as possible so that the flow of foreign capital can be of mutual advantage. The underlying idea of such safeguards should be to avert the creation of vested interests in the borrowing countries. The terms and conditions insisted upon by foreign capital must be

made to fit in with this fundamental condition from the borrowers' side..

Sources of External Finance

Granting our need to borrow some money from abroad to supplement our internal capital, the next practical point to consider is who will lend us such finance ? It would be more correct to ask who could lend us. The suggestion regarding borrowing from one's debtor does not make good commercial sense. England's indebtedness to us has already exceeded a thousand crores of rupees mark, and the figure has been further mounting up. Besides, she herself desperately needs a loan from America. One occasionally reads about England's willingness to lend us. While this is appreciated as an expression of goodwill by Britain's industrialists and financiers, it is only fair to suggest that if Britain has any surplus funds of this nature she should utilise them first for the repayment of the vast sums of money she owes India.

The only other country in the world today that may lend us is America ; but her desire to lend does not appear either very strong or pronounced. There are other prior claims on her savings. She is already under an obligation to lend England and war-stricken Europe. Then there is China, South America and the South West Pacific countries. India, I am afraid, is very low down on America's list of lending priorities. This is a fact that is not sufficiently appreciated. The real position is that even if we need and desire foreign capital, we cannot get it in the immediate future in the required quantity, if at all, and shall therefore be forced to fall back on our own resources.

The Method of Borrowing

It is clear from the above that extensive borrowing from foreign countries should be ruled out under present conditions at least for some years to come. I am aware that there is a strong body of public opinion in India in favour of foreign borrowing; but no attempt has been made by this school of opinion to specify the method of such borrowing and the terms. The clamorous demand for foreign loan is in itself a sign of weakness and foreign capitalists will not be slow to take advantage of it. The average Indian industrialist is neither organised nor strong enough to negotiate on equal terms with powerful foreign financial or industrial

interests and there is therefore always the danger of an individual borrower in India being compelled to accept terms that may not be in the best interests of the country. The history of private international borrowing should be a sufficient warning to India. I would, therefore, suggest that if at any stage foreign capital is found to be necessary, such requirements should be estimated from time to time by the Government and the money should be raised as loans to the Government from foreign countries. In this way we could not only get more favourable terms but could also avoid the danger of any proprietary interest in Indian industries being vested in foreign organisations. The Government, after raising the loans should distribute the same to the industries that require them. In certain industries involving the use of international patent rights and requiring the assistance of technical skill and inventions of the highest order, it may be necessary, as I have already stated, to grant a share in the ownership, control and profits. But in all such cases, the terms of private borrowing must be communicated to the Government and necessary approval obtained for the same.

I also attach great importance to the method of repayment. Foreign borrowing should be on a planned basis. An equally effective plan should be laid down at the same time to govern the repayment of these foreign obligations. It is essential that the lending countries should be prepared to buy our goods. Loans should definitely be terminable. They should be authorised and repaid within the prescribed period. of course, as old loans are repaid, new loans may have to be raised to finance new schemes and ventures. The point I wish to emphasise is that our foreign obligations should never be allowed a runaway career without the proper economic set-up. They should be fully within our means to discharge within a reasonable period of time; they should be utilised strictly for productive and developmental purposes; they should not confer upon the lending powers any authority or in fluence, let alone control over our economic affairs, and they should never be permitted to dislocate or interfere with the smooth working of our system of currency, credit and foreign exchange.

The Question of Repayment

The question of repayment mentioned above has one important aspect which requires elaboration. The debtor country has ultimately to repay loans by creating an export surplus in goods.

This raises considerations both from the point of view of the debtor and of the creditor countries. From the point of view of the debtor countries, repayment becomes easier when exports are diversified. The difficulties that may arise in the absence of this are vividly brought out from the case of the Latin American countries which have resoted to foreign lending in appreciable amounts, Most of these Latin American countries have "one crop" economies depending on one or at the most two products to acquire foreign exchange. Before the last depression, tin constituted 73 per cent. of Bolivian exports, coffee 71 per cent. of Brazilian and 61 per cent. of Colombian exports, nitrates and copper 84% of Clinean, petroleum and copper 58 per cent. of Peruvian, and oil 76 per cent. of Venezuelan exports. Such a position is not necessarily dangerous at all times, but in the face of a general fall in prices such as occurred between 1929 and 1933, there was little that could be done to protect these countries from the shrinkage of export surplus with which to repay their foreign loans. The real solution of the problem lies in making the export list of debtor countries more diversified, by producing manufactured goods both for home consumption as well as for export. A situation of this nature is already developing in these countries and many manufactured goods, previously imported, are being produced at home. If such development continues, as seems probable, the balance of payment of these countries will undergo a radical change. They will import less manufactured goods than previously and their export surplus, which may well increase, will be used to pay for capital equipment to develop industries directly competing with some of the export industries of the creditor countries. If in these circumstances the creditor countries, as a result of a shortsighted policy, restrict imports from the debtors, this will, of course, ultimately lead to a shrinkage in their own volume of exports to the latter as in the long run total exports must pay for total imports. The creditor countries should never attempt to be simultaneously a net exporter both of capital as well as commodities. If they do, they may thereby kill the goose that lays the golden eggs. The United States, which is now the foremost creditor country in the world, should seriously bear this in mind. She must lower her tariff walls and be prepared to receive a larger volume of goods than hitherto from debtor countries to enable the latter to repay their loans. In the inter-war period the U. S. A. did not do this, with disastrous consequences now too well-known to her own economy as well as to that of her debtors.

Conclusion

I trust I have said enough to show the diversity between the postulates of economic theory and the practical experience of borrowing countries in respect of foreign capital. I might perhaps make bold to say that there never was nor will there ever be a cast-iron case for or against borrowing from foreign countries. But what the situation requires to divest it of all its dangers and to secure from it the fullest benefits is a keen awareness of its incipient perils and a proper appreciation of the conditions on which foreign loans are sought and obtained and, what is most important of all, the purposes for which foreign loans are utilised. To abstain from foreign loans altogether may in more cases mean unwarranted privation and hardship on a national scale, while unrestricted resort to them might involve the country in grave political risks. Foreign capital must be the means of securing that co-operation among the nations without which all economic progress and the general improvement of international standards of living would be but an idle dream.

II

A NEW APPROACH TO THE ANALYSIS OF THE THEORY OF AGRICULTURAL INDEBTEDNESS

BY

P. S. Narayan Prasad

The analysis of the problem of rural indebtedness in this country may have to be approached on lines different from what so far has been the practice, if we have to find a truly valid solution to it from the point of view of economic theory. It has been the impression of this writer that the rural debt problem is capable of analysis in terms of the general principles of economic theory in the same way as the problem of unemployment in industrial countries. A study of the rural debt problem not only in India but in various other countries, a study of the manner in which it seems to be correlated with the other facts of economic life as well as the manner in which its volume seems to fluctuate as between times of boom and depression would further confirm the belief expressed above. The suggestions made in the following paragraphs, no doubt highly tentative, are meant to arouse discussion as to whether this kind of analysis of the the rural debt problem in terms of the general theory is or is not possible and, if so, how best it might be organised.

Before proceeding further, it may be useful to introduce here briefly the assumption, that there is a state of disequilibrium at least in some sections of Indian agriculture in terms of che cost-pric', relationship. This assumption is based on the following observa-as ons. The long-period trend of agricultural prices (speaking ma" of of the period between the wars) had been generally down'; but This was due mainly to the opening of new agricultural luded and the intensification of the application of capital in agrion. In,t as in industry and the resultant larger yields per acre ,3 knownce Another cause working in the same direction perhaps was t' know and tion of the methods of large-scale production with all , the the m:ch the economies. On account of these causes, it is obviou-n note;rist on culture, particularly in the newer countries, productivast din agricul- unit improved. In India, on the other hand, it :

that the change in productivity has, except perhaps in a few cases, been absent, or even'may be, is in the negative direction. These and the comparative reduction in the demand for agricultural staples on the international market have tended to bring down the level of agricultural prices in relation to other prices. As against such international factors, in our county there has been a growth of population and relatively to this, an absence in the growth, in proportion, of the acreage particularly under foodcrops, resulting in a deterioration in the quality of the human beings as well as the livestock, the two most important sectors influencing productivity in agriculture. This problem been accentuated by the reckless growth of sub-division and fragmentation influnced largerly by the growth of population, the universal prevalence of disproportionate burdens on the agricultural classes in the shape of rent, revenue and interest rates and the general absence of modern practices in its business and marketing aspects. The net effect of these causes has brougbt about a rise in the costs of agriculture, a tendency which is the reverse of what is noticed in other progressive agricultural countries. In view of this, it is probably safe to conclude that for a long time, but certainly between the two wars, Indian agriculture has been caught betwen a downward-moving price level and an upward-moving cost structure. It seems necessary that any suggestions and plans made for the improvement of Indian agriculture will have to take this as the starting point of analysis; and, in any case, it is clear that a study of the inter-relation between rural indebtedness and the other factors in economic life will have to be mainly from this angle.

That there is this kind of disequilibrium in Indian agriculture ay be inferred also from the fact of the presence of what is nor- lly describel as the deficit economy. It is commonly accepted the Indian agriculturist lacks a business view. It is well-known ne can hardly get out of him any idea of the costs involved he profits realised. There are, barring a few larger and landlords who might be keeping such an accountant's gricultural operations, several who carry on season after hout much though about the relation between, what hly described, as the value of the input and the output. ole probably there will be many who, were they ccounts, will discover that they are carrying on,

business parlance would be described as a losing proposition. But how, it may be asked, is it possible for anyone to carry on for years, if there are only losses? The question is not without answer. Firstly, this state of affairs is rendered necessary or possible in some cases by the absence of any alternative employment consequent upon the crowding on land of population which is unemployable elsewhere. This makes it compulsory to reduce continually at the margin the wage rates. In other words, what is suggested here is that sections of our agriculture are really what might be described as extra-marginal; that is, they lie beyond the profitable margin of cultivation. It is normally assumed in most discussions, particularly in books on economic theory, that cultivation beyond this margin is generally not undertaken because it would not be worthwhile. But that proceeds on the assumption, which is absent in Indian agriculture, and possibly too elsewhere, that the agriculturist *has* a business view and, therefore, is able to know when his agriculture is and is not paying. In India, this being absent, an agriculturist will proceed with his cultivation even while it may not actually be paying so that the real margin of cultivation, that is the point up to which extension of agriculture will be taken, lies beyond what is described as the profitable or economic margin of cultivation. In that sense, it appears necessary to recognise the existence, in the peculiar circumstances of the agricultural industry in India at any rate, of two margins of cultivation, the one, an economic margin and, the other, the actual margin of cultivation extending beyond this economic margin of cultivation.

It may be contended whether such a thing is really possible. That it is possible may be inferred from the following arguments: Firstly, even in the present highly inflated price levels there is, practically speaking, the same area under cultivation as there was in the pre-inflation period which shows that the economic margin of cultivation has been extended by the increase in price level; but only *within* the area of the second margin, already alluded to, and which lies beyond the economic margin of cultivation. In fact, in agriculture, not only in India but also elsewhere, it is know that a downward movement of price sometimes has been know bring about not, as is to be expected, a contraction in the m of cultivation but actually an extension, as it has been note study of the League of Nations in the course of the last de

that during years of falling price levels in several of the agricultural countries the area under cultivation actually increased with a fall in prices, the farmers trying to compensate for a fall in value by an increase in quantity ! Such a phenomenon undoubtedly compels us to sit down and revise our notions about what has been tacitly accepted as the economic margin, and if these facts are true obviously the real margin of cultivation actually lies away from the economic margin of cultivation ; and that fluctuations in price levels would induce fluctuations in the extent of the difference between the economic and the actual margins of cultivation. Now to be able to say quantitatively how much our agriculture really lies beyond the economic margin of cultivation with any definiteness is not possible at this stage, for, obviously, it is not all agriculture that is run as a losing proposition but only a part of it. How much is this part may no doubt vary both from area to area as well as from time to time depending upon the nature of the price level and the changes in costs. For example, it is presumably right that in areas with good irrigation facilities there may not be much area that can be described as extra-marginal ; while in dry regions like those in Rajputana or elsewhere, where agriculture depends largely on rainfall etc., there may be a good slice of it which is largely a deficit business. Similarly, sections of agriculture which may be regarded as extra-marginal in depression times will have ceased to be so during times like the present, when agricultural prices are at very high levels. In that sense, therefore, one might visualise a region between the economic and the actual margins of cultivation, fluctuating in relation to various factors, but mainly in relation to the price and cost structures and the general environmental factors determining the productivity in agriculture. This fluctuation induces us to draw other inferences on the basis of which we may try to compare, this problem with the problem of unemployment in industrial economies. But before proceeding to do so, one further question may have to be answered and that is, if there are sections of agriculture which are thus to be described as losing propositions, ow could they continue to exist at all? Why would the agriculturist, instance, carry on day in and day out if he were to realise only s and, in any case, how is he enabled to do this particularly if, the case with the Indian agriculturist, he has no capital and, e, no means of financing such deficits at all ?

The answer to this question is to be found in the explanation suggested below for a fuller investigation and analysis in terms of statistical studies. During times of depression, the extra-marginal belt becomes wider and in that proportion the real burdens on the agriculturist of rent, revenue and interest charges become heavier and create a deficit budget. These charges he meets by borrowing and thus continues to be in business. In this way, he is enabled through the mechanism of borrowing to integrate as far as possible his losses in lean years with profits in the better ones. Thus, many people who in periods of depression contract debts are enabled to clear them during periods of boom. But, obviously sometimes it also happens that if particular lands continue to remain for long periods below the economic margin, continued borrowing leads to the growth in that volume of debt to a level beyond which borrowing becomes impossible and results in the acquisition of the land by the moneylending classes (including the better class landlords) resulting in the ejection of its owner at the moment. It is this factor which explains the large growth of the landless labour class in India side by side with the general downward trend in agricultural prices and the growth in the volume of indebtedness, all of which are, as described above, corelated factors. The classes who acquire these lands are either the money-lenders or the more prosperous landlords who are partly money lenders and partly agriculturists. The later taking good and bad lands together find it possible on the whole to carry on cultivation although with depressed average income per acre. This may also be inferred from the fact that in agriculture, unlike in industry, price fluctuations tend to produce fluctuations in income rather than in the volume of employment or production, or the acreage under cultivation; and changes in the volume of income are reflected in changes in the volume of indebtedness in agriculture as a whole. So far as the moneylender is concerned, he finances both the prosperous as well as the extra-marginal cultivation. On the latter, he either loses or, through indebtedness, manages to get control of lands or makes up for the losses on the extra-marginal cultivation by the gains made by lending capital at exorbitant rates of interest to the more prosperous cultivators. He thus realises on balance roughly normal returns; but he does this by losing at one end and overcharging at the other. This is the mechanism by which the moneylender on the one side and the supra-marginal agriculturist on the other side have presumably been taking up the losses in agricul-

ture up to a point; and beyond this the landholders are dispossessed and are added to the group of landless labourers, thus effecting the equilibriating function between sections of agriculture which do and sections which do not pay their own way.

If the hypothesis suggested above is correct—that changes in indebtedness take place side by side with and in some proportion to changes in the volume of income, this itself being induced by changes in the level of agricultural prices—then we can connect changes in the volume of indebtedness with changes in the level of agricultural prices, and we may say that just as there is a certain portion of land which is extra-marginal there is also a certain portion of this indebtedness which is in excesss of the normal credit requirements of agriculture; that is, if at the level of equilibrium we assume that an economically justifiable volume of indebtedness is 'X', the actual volume of indetedness, in so far as there is extra-marginal cultivation, may be something more than 'X'. This excess over the normal volume of indebtedness at equilibrium level may be taken to represent roughly the consolidated losses accruing from the extra-marginal cultivation, and it may be suggested that as the extra-marginal cultivation varies this volume of uneconomic indebtedness also varies, and changes in this account for the periodical increase and decrease in the volume of indebtedness. This indebtedness which represents the consolidated losses from agriculture may be compared with the phenomenon of unemployment in industry. Both these are intimately related to movements in the level of prices and the other factors related to the trade cycle, and should be capable of being analysed with reference to the relationship between saving and investment and the rate of interest in the same way as the unemployment analysis in the Keynesian Theory. Of course, some very obvious limitations are that the conditions of investment in agriculture are not at all identical with those in industry; nor, as already discussed, is the sense of calculation with reference to the rates of interest and the marginal efficiency of capital so fine. Still, while these are limitations, the rough trend of analysis will have to be with reference to these factors; and, in any case, whether an exact parallelism between the saving and investment analysis in relation to employment and agricultural indebtedness can or cannot be established, it is obvious that there does exist a relationship between price level and the volume of indebtedness, and in that sense it is legitimate to pursue a study of the rural debt analysis correlated

with factors affecting the price level—wages, interest rates, marginal efficiency, etc.—as the most correct.

All these hypothesis will need patient analysis on the *a priori* theoretical plane, but also on the plane of statistical investigations. In this country, as in every other sphere, satistical data in regard to agricultural conditions are woefully deficient, particularly with reference to the cost-price relationships. The investigations made by the Punjab Board of Economic Inquiry in regard to various conditions do throw some light; but they are neither deep nor extensive enough to enable wide and reliable generalisations, although they do reveal, for instance, such facts as the existence of differences in productivity on similar lands under different systems of tenure and so on. The survey of Wai Taluka by the Gokhale Institute of Economics and Politics under the able guidance of Principal D. R. Gadgil has done excellent pioneering work in this field of study of the cost-price relationship; but it is only the beginning and many more surveys of a similar kind in different regions and applicable to different types of agriculture will have to be undertaken if any general deductions from the facts are to be drawn. But even for the organising of statistical material some hypothesis to start with at any rate would be essential and the ideas suggested in these paragraphs are merely tentative suggestions for investigations on particular lines in this direction with a view to verifying whether or not actual facts bear out such assumptions.

But if these assumptions are even roughly correct, certain valuable deductions for practice may be drawn. Firstly, to the extent to which sections of agriculture are not run on business lines and parts of it are run uneconomically, it remains to be examined to what extent cheap agricultural credit can be a penacea for agricultural problems. It is perhaps true in this country especially, that the agriculturists can borrow in excess of what is justified by the return on land. This is rendered possible by the fact that the borrowing capacity of agricultural lands is greater than what it ought to be. There is a certain over-valuation of lands, the degree of which perhaps varies, due to an excessive preference for land in this country as a channel of investment, next, if at all, only to precious metals. That being the case, land values are probably higher than what income-yielding capacities would justify and this enables the agriculturists to borrow more than what under strict business conditions wouid be possible. In

several cases, for example, it has been noticed even in the operation of the co-operative societies that in many provinces loans even after years could not be repaid by the borrowers, and as outlined in the *Review of the Co-operative Movement* several provinces during the period of depression found it necessary to write off large volumes of debt running into lakhs of rupees as the only solution. This stands explained by the theory outlined above, namely, that agriculturists having lands which are over-valued are able to borrow but in relation to their income-yielding capacities are unable to repay. This might not be true in all cases but in a general sense that the non-payments are more common in times of depression does indicate inability rather than unwillingness to repay. If this is true, the conclusion will follow that it will be difficult to integrate the rural debt structure in agriculture with the rest of the money market, because if it is an industry which is continually making losses, then the burden of those losses will automatically be transferred to agencies which undertake to finance it; that is to say, if some central agencies are created specially for financing agricultural loans they will, like the co-operative societies, sooner or later face the problem of failing to recover the advances and will have to write off large arrears that cannot be recovered; or, if this cannot be done, they will have to stop the schemes or financing agriculture which would then have to fall back on the older methods. That is a dilemma out of which a solution can be found only if agriculture is rendered a paying industry or, alternatively, the state accepts it as a policy in the interests of the agricultural population to write off periodically these accretions of debt; but, in a practical sense, how much can thus be written off and whether in the interests of practical policy it is good to encourage a system of regularly writing off debts are matters which need to be carefully considered.

Obviously, if the problem of rural indebtedness has to be reduced to the business problem of providing finance for agriculture which is worthwhile, what is necessary to be planned is that the extra-marginal cultivation should be reduced as much as possible. This, in terms of equilibrium theory, can be done either by reducing the costs or increasing the prices, With regard to the latter, there are some obvious limitations in the sense that the price level is largely a creature of international circumstances and its control nationally at a particular level, at least in the long term, may not be feasible. That leaves then the only alternative of reducing costs.

To some extent, a reduction in the cost level can be worked out by a more reasonable apportionment of the elements of cost. In India, at least one of the elements of cost, the land tenure, is excessive if it is considered as a tax and the burden of tax is compared with that on other incomes. The absence of graduation, the absence of a minimum taxable income and the general arbitrariness in fixing of assessments in ryotwari areas are all factors which, no doubt, indicate that the burden of land revenue on agricultural incomes compares very unfavourably with that of taxation on incomes. In a well-ordered economy it should be posssble to readjust the taxation on land incomes so as to make them more equitable and more economical. To some extent, the rate of interest also is high, particularly where agricultural finance is provided through the money-lenders' agency. Of course, in some cases, the high rates of interest are really fictitious because they remain more or less paper rates, the actual realisations in numerous cases being different from the paper rates and the average rate being perhaps not too high in relation to the risk factors; but, nonetheless, if a comparison were instituted between the income-yielding capacity of lands and the rate at which capital is borrowed for the industry, it would perhaps be apportioning out of the agricultural income a larger than the equitable share to owner of capital and rent-receiving landlords and discriminating against the tiller of the soil whose wages on this account get unduly depressed. Thus, in any planned scheme, if the rate of interest on capital made available to agriculture could be lowered say, through the pursuit of a cheap money policy, and the tax (revenue) burden also could be reduced, something will have been achieved towards reducing the cost level in agriculture. Probably the elimination of the middleman between the cultivator and the State would also contribute to a substantial reduction of the cost level, and here problems of land tenure and problems of market finance will become relevant.

Of course, to a notable degree, it will also be necessary to improve the efficiency of the factor of production labour. which both on account of its excessive quantity as well as the unfortunate conditions in which life of the average rural agriculturist is cast, is deteriorating rapidly in quality. This implies taking stock of the whole set of influences, material, political and social, which together are acting to hold this down: that is a large inquiry into which it would not be possible at this stage to dilate: But one prominent

fact which needs to be emphasised, perhaps, is this that there is an intimate relation between numbers and efficiency and even if there is no deliberate exploitation of one factor by others as may be true at present, an excessive increase of population unaccompanied by a proportionate increase in the volume of capital available for investment and cultivable land in agriculture would naturally result in a state of affairs in which capital and land ownership would tend to extract a larger share of productivity at the margin than is possible for labour. On account of the fact that this marginal productivity of labour, compared with that of capital, is automatically deteriorating, it requires to be tackled through a deliberately aimed policy for the control of numbers that have to subsist on land, whether this is attempted through drawing away population from land on to other lines, or by the control of the rate of growth of population. But, in the circumstances prevailing in India, it seems true that less attention is devoted to the question of numbers than it deserves and the time *has* come when we cannot afford to neglect a more serious consideration of policy in relation to the volume of population as one of the pre-conditions for the success of a policy of increased productivity, efficiency and wages if not, indeed, for all planning This might appear to be a digression from an analysis of the theory of rural indebtedness but it is relevant through its influence on the cost structure; and the volume of indebtedness cannot perhaps be reduced without a proper tackling of the problem of agricultural wages which are pitched low partly because of the excess of numbers in relation to the demand for them on land.

III

INDIGENOUS BANKING IN INDIA

BY

V. L. D'Souza

The system of indigenous banking is an institution in itself, with its fine traditions concerning the respectability, integrity and resourcefulness of the indigenous banker, his hereditary relations and close personal contact with his clientele and simple and popular methods of work. The system has stood the test of centuries and has by no means exhausted its usefulness and its capacity as a credit agency. Its development has naturally proceeded on the lines suited to the financial and commercial genius of the people, their requirements, habits, customs and business practices. Though called a system, however, it is not organized on the lines of modern banking institutions.[1]

There are diverse castes and classes of these indigenous bankers. They are popularly known by the appellation of *Shroffs*, *Marwaris*, *Multanis* and *Sahukars*. They perform the principal functions associated with modern banking except that they do not allow cheques to be drawn on customers' accounts, and that in one material respect they exceed the legitimate scope of modern banking. They draw no distinction between dealing *in* other people's money and dealing *with* it. Thus many an indigenous banker combines trading with banking proper.[2]

If banking activities only are taken into consideration, it is in the methods rather than in the range and variety of transactions that the shroff stands in marked contrast to his modern analogue. The indigenous banker dispenses with the formalities and procedure incidental to organized banking. He prefers to do business on his own and by his own well-tried and well-worn methods. The joint-stock principle by which resources and talents are pooled together does not appeal to him. He believes in close personal touch with his clientele. He knows the history of the borrower and all the

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[1] Jain, ***Indigenous Banking in India***, P. 27.

[2] ***Report of the*** Bomb*ay* P*rovincial Banking Enquiry Committee*, Vol. I, p. 196.

details concerning his business and financial position. He knows whom to accommodate and to what extent. After giving a loan, he is in a position to watch the borrower's transactions with a closeness denied to the organized but impersonal bank. His system of accounting is based on the simplest principles. He keeps only a few books, in most cases only a day-book and a ledger. No balance sheet is published ; no audit is conducted ; no elaborate staff, no attractive counter, no imposing edifice ; and no particular hours of business.

The clientele of the indigenous banker is drawn from the ryots, the small industrialists and the traders. It is not ordinarily possible for him to establish direct contact with the ryot. He finances agriculture through local *sahukars* or money-lenders. His relations with the small industrialist and the trader are direct. And in connection with such financing operations he does a good deal of general banking business such as buying and selling, remittance, discounting hundies, receiving deposits and advancing loans against stock-in-trade. It is not unusual for the indigenous banker to issue cheque books though these cheques have only a local circulation.

Generally speaking the indigenous bankers combine banking with some form of trade. They do not distinguish the capital employed in banking from that employed in trade. The mixture of banking and trade is quite a characteristic feature of the *sahukar* and the *shroff*. In recent years there has been a tendency to shift the emphasis from banking to trade owing chiefly to the competition of the joint-stock and co-operative banks and the establishment of branches of exporting firms in *mundis*. There are at present three kinds of indigenous bankers, namely, those who are principally bankers, those who are principally traders and those who are both bankers and traders.

The indigenous bankers work independently of one another. Co-ordination is lacking among the various classes of these bankers. In a few centres they have organized themselves into associations, *e.g.* the Bombay Shroffs' Association and the Association of Shroffs at Calcutta. On the whole the indigenous banker works on his own. There is no organization for interchange of intelligence or for mutual help.

The relations of the indigenous bankers with organized banking institutions are still in a rudimentary condition. In all provinces

the *hundis* are discounted is about 2 to 3 annas per month per cent. or between Rs. 1-8-0 to Rs. 2-4-0 per annum.[5]

The funds of the indigenous bankers are employed in lending to borrowers against *muddati hundis* or sometimes against promissory notes. The *muddati hundi* is usually drawn for a period of 90 days. *Darshani hundis*—sight or demand drafts—figure mostly in remitting funds. The *muddati hundi*, which is the most popular credit instrument, may or mav not be accompanied by any document of title to goods. It is therefore not possible to determine whether such *hundis* are merely in the nature of accommodation bills or have been drawn in connection with genuine trade transactions. The fundamental fact to be recognized is that moneys are lent primarily against the personal credit and standing of the borrowers.

The indigenous banker is by far the most important constituent of the bazar money market. It is by no means an easy task to describe the organization and activities of the indigenous banker, for as a rule he is very secretive, averse to publicity and resentful of enquiries into his methods and dealings. A *multani* banker, who may be regarded as typical of his class, in his letter to the Reserve Bank expressed himself thus: "Our business is based on strict privacy and it will greatly hamper our business if we make up our mind to show our account books."[6]

There is considerable difference of opinion as to what constitutes the essential function of the indigenous banker. Some stress "acceptance of deposits" as the distinguishing feature while others emphasize "dealing in hundis". The Indian Central Banking Enquiry Committee and the Reserve Bank of India are inclined to take the former view while recent enquiries lend support to the latter view. For all practical purposes by "indigenous bankers" is meant all bankers, other than joint-stock banks and Co-operative societies, who receive deposits, land money and deal in *hundis*.

Various proposals have been made for linking the indigenous bankers with the general banking system of our country. It will take a long time for the setting up of organized branches of joint-stock or co-operati e banks all over India. Ultimately and in the long run the indigenous banker is bound to give way as modern banking spreads. But as far as the future can be foreseen the

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[5] Ghosh, *Study of the India Money Market*, P. 229 et seq.

[6] *Statutory Report of the Reserve Bank of India*, 1937, Appendix C.

indigenous banker will continue to be an important source of credit in towns and a main source of credit in rural areas. Indigenous bankers, moveover, have been traditionally dealing in the *hundis.* Their training, experience and resources can be utilized in the development of the bill habit and the organization of a bill market.

The problem of how to improve the position of the indigenous banker and how to make him a useful member of the Indian banking system was discussed by various Provincial Banking Enquiry Committees. The finding of these Committee were assessed by the Central Banking Enquiry Committee in 1931.[7] Many changes have taken place in the Indian Money Market since the reports were issued, changes which call for a re-assessment of the proposals made by them. The main lines of reform may be sketched as follows :

In the first place, the indigenous banker should be linked with the Central Banking Institutions of the country as their agents, especially so in places where organized banking is not functioning. It goes without saying that the indigenous banker should submit himself to restrictions which will eliminate risks arising from the peculiar character of his business. The Imperial Bank of India has been utilizing the services of the leading *shroffs* and *sahukars* in the mofussil for the collection of bills and cheques, but the policy has been half-hearted and hesitant since the Imperial Bank, largely through fear of competition, appears to be opposed to its agents undertaking any business on their own account.

Secondly, indigenous bankers, on satisfying certain conditions, should be treated as "member banks" on the approved list of the Reserve Bank of India The principal conditions are that they keep a proportion of their deposits with the Reserve Bank, that they submit their account books to periodic inspection and that they conform to the banking standards prescribed by law. In return the indigenous banker will get the same facilities for rediscounting commercial paper as the jont-stock banks which are "member banks "

Thirdly, commercial banks including the Imperial Bank of India should discount the bills of indigenous bankers to a much greater extent than they do at present. Complaints are frequently made that local branches of the organized banks refuse to rediscount *hundis* bearing the endorsements of indigenous bankers of the highest repute No doubt the question of discounting and redis-

[7] *Report of the Indian Central Bankiug Enquiry Committee*, Ch. VIII, p 94.

counting is largely a matter of security but where the security is good it should command all the banking facilities to which it is entitled.

Fourthly, Governments in India should encourage the re-organization of indigenous banking firms on modern lines by the grant of various facilities, the chief among them being the appointment of such institutions as Government bankers. In places where there is no branch of the Imperial Bank, Government balances may be left on deposit with them.

Last of all, attempts should be made to constitute a class of "licensed bankers" on whom certain privilages should be bestowed in return for certain definite obligations imposed upon them. The more important privileges are (1) a summary procedure for determination of suits and execution of decrees, (2) facilities to remit funds through the Imperial Bank or the Reserve Bank at the same rates as are charged to all joint-stock banks, (3) grant of rediscount facilities by the Imperial or the Reserve Bank on the same terms as are given to joint-stock banks. The reciprocal obligations to be imposed relate to (1) proper audit of accounts, (2) conduct of business in accordance with rules laid down by the Indigenous Bankers' Association, (3) limitation of the maximum rates of interest to be charged for different kinds of business and (4) maintenance of a cash reserve on a prescribed scale.

It is of the greatest importance that, in the interests of the general public and of the indigenous bankers themselves, steps should be devised to strengthen the position of these bankers. Out of 2,500 towns in India, joint-stock banks and their branches exist in less than 400 places. For banking facilities in the rest of the country, agriculturists, traders and artisans must depend on money-lenders and indigenous bankers. Even in localities where a joint-stock bank exists, the indigenous banker continues to render valuable services by way of remitting funds and financing inland trade and medium-scale industries. Generally speaking the indigenous banker's rates of interest do not compare unfavourably with those of ordinary joint-stock banks. He renders most important service and from all accounts does not charge too high a price for it.

Doubt is cast on the usefulness of compulsory measures to reform indigenous banking. Such measures will not be welcomed

by the *shroffs* and *mahajans*, Compulsion would only accelerate the procéss of driving out these bankers from banking to trade and business which would create a most serious gap in the banking system of the country. The aim should rather be to restore these bankers to the place which they enjoyed in India until the middle of the last century consistently with modern methods and standards of banking business. It is but right that indigenous banking should be brought into the direct relations with the Raserve Bank and thereby provided with rediscount facilities from that institution. But the Reserve Bank like all central institutions can only rediscount bank-endorsed paper. Hence only those indigenous bankers who are engaged in banking proper, or those who are prepared to shed all their activities other than banking, should be eligible to be placed on the approved list of the Reserve Bank in the same manner as joint-stock banks

As immediate need is the formation of an association of indigenous banks and bankers. It may be called the All-India Bankers' Association. Such an association will give the indigenous bankers a status. It will tend to raise the standard of their business habits and improve their banking methods.

A line of reform often put forward is the establishment of what are known in Germany as "Commandit" principle banks. The joint-stock banks may entrust licensed or registered money-lenders or indigenous bankers with such agency functions as accepting deposits and making remittances and payments. It would remove some of the obstacles to branch banking in India, namely, the complete ignorance of the urban banker as to the conditions prevailing in the mufussil and the high cost of running a full-fledged branch in the interior parts of the country. If the agency business develops the licensed shroff may be transformed into a branch of the financing bank. Or if it is desired to limit the liability of the bank it may enter into partnership with him on the "Commandit" principle, that is, by the bank becoming the financing partner of a local *shroff*. By such an arrangement the advantages of unlimited liability and the local knowledge of the *shroff* are retained while the bank is spared the expense and liabilities which it would have to incur if it had to open a new branch in the locality.[7]

The question of the effectiveness of the Reserve Bank's control over the money market has become complicated because of the two

[7] *Report of the Indian Central Banking Enquiry Committee*, P. 110.

sections into which it is split up, namely, the organized section and the bazaar section. While the Reserve Bank can exercise a considerable measure of direct influence over organized institutions through the Bank Rate and the Open Market Operations, its control over the credit situation in the bazar market is almost conspicuous by its absence. Indigenous bankers and money-lenders will have to reorganize their business methods before they can become amenable to the Reserve Bank control and be entitled to the Reserve Bank assistance. As things are at present, the Reserve Bank exercises some indirect influence over the bazaar. It is not unusual for operators in the bazaar to approach the Imperial Bank and commercial banks for discounting their bills and for securing advances against approved securities. They thus expose themselves, though indirectly, to the regulating influence of the Reserve Bank which supplies funds to the various joint-stock banks. Recent years have shown a lessening of the gap between bazaar rates and the Imperial Bank Hundi Rate—a proof of the gradual development of an organic relationship between the two markets and a proof also of the widening of the scope of Reserve Bank action in the Indian Money market as a whole.

A Bill purporting to consolidate and amend the law relating to banking companies was introduced in the Central Assembly in November 1945. Hitherto the law relating to banks and banking business has been scattered over a number of unconnected Acts. It has become imperative to bring all these provisions into one Act, to co-ordinate them, and to bring them into line with modern needs and also to provide for the recent rapid growth of banking resources and the considerable expansion in the number of banks and their branches. These objects are no doubt laudable but the proposed law applied only to *incorporated* institutions, namely those which come under the provisions of the Indian Companies Act. Individuals or partnership firms doing banking business as *sahukars*, *shroffs* or *mahajans* did not come within its purview. It must be recognized that these people do the bulk of the country's banking business, financing the small industrialist, the trader and the agriculturist in large part with their own money and quite often with deposits obtained from their customers. They serve as links with local trade, industry and agriculture and as feeders to the joint-stock banks and their branches in the principal towns. Banks coming under the definition and scope of the Bill are very few in India to-day considering the size of the country, its population and the extent of it agriculture, industry and

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commerce. Moreover, since such banks and their branches are largely concentrated in the cities, the rural areas would be left without any organized banking service. As the bulk of rural financing is in hands of indigenous bankers, any legislation that leaves them out of its scope would have to bear the reproach of being defective and applicable to only one sector of the credit structure of the country.

The indigenous bankers are now an important and indispensable element in the financial system of the country and they will continue to remain so. Their resources are limited, their methods are antiquated, but they maintain standards of integrity which are high; they possess wide knowledge and varied experience which is at the disposal of the country. India would be much poorer for their extinction. The proper aim should be not their extinction but their reform.

Several lines of advance are open to them.[8] They must decide for themselves by which road and at what speed they will move. The possibilities are :

(1) the transformation of indigenous bankers into private limited liability companies,

(2) the amalgamation of the business of local indigenous bankers into joint-stock banks,

(3) the establishment of what are known in Germany as "Commandit" principle banks,

(4) the appointment of indigenous bankers as agents of the joint-stock banks,

(5) the formation of a co-operative bank of indigenous bankers,

(6) the adoption of bill-broking as an integral part of the indigenous bankers' business, and

(7) the re-organization of indigenous banks into modern banks.

Indigenous bankers are responsible for supplying the bulk of agricultural credit and financing most of the inland trade and industry of the country. Their importance in the Indian Money Market may be gauged by the fact that while there are about 350 places served by joint-stock banks, there are no less than 2,575 moderate sized town and 700,000 villages in which the indigenous banker is the only source of credit. Even in important cities like Bombay where

[8] *Report of the United Provinces Provincial Banking Enquiry Committee*, p, 283.

there are branches of joint-stock banks, he plays an important role as a financier.

The problem is how to bring the indigenous banker within an integrated system of the money market, or what comes to the same thing, how to link him with the Reserve Bank of India. His instincts and traditions are towards a highly individualistic business, and as he very largely depends upon his own resources, supplemented by credit from his fellow *shroffs* or from joint-stock banks, in case of necessity, there is little inducement for him to submit to the formal restrictions involved in his incorporation into the organized banking system. To him the restrictions are galling and the corresponding advantages not clear.

The Reserve Bank of India has formulated a scheme for linking the indigenous banker with the central money market of the country. The conditions laid down by the Reserve Bank may be briefly set forth. Indigenous banks, if they wish to come into practical relationship with the Reserve Bank, should formalise their methods of business on lines approximating to joint-stock banks and in particular they should develop the deposit side of their banking activities. Judging from the replies received from the representatives of indigenous bankers, these conditions appear to be too harsh. Few were disposed to abide by the conditions regarding the taking of deposits and giving due publicity to accounts. Some were agreeable to the conditions regarding the maintenance of accounts in approved form.. Though all agreed that speculative business should be ruled out, none of them was prepared to confine himself to banking business only. In short, they desired the scheme to be so modified as to be incompatible with the general aim and purpose of a Central Bank.[9]

While the integration of the indigenous bankers remains an open question, progress may be made in the development of an open bill market in which first class bills are freely negotiated. If such a market could be developed it would be possible, on the one side, to extend the open market operations of the Reserve Bank to trade bills just as it is done at present to Government securities and, on the other to bring about a direct relationship between the *shroffs* and the Reserve Bank without compelling them to submit to unduly rigid restrictions and to modify the essential character of their business.

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[9] *Statutory Report by the Reserve Bank*, p. 42.

The creation of a bill market pre-supposes the formation of acceptance houses, reduction in stamp duty and some legislative regulation of the indigenous banker. The Reserve Bank by agreeing to accept paper bearing names of approved parties will aid in the organization of a discount market. The eligible paper will of course be presented through a scheduled bank and this will encourage the commercial banks to give the indigenous bankers facilities to organize a bill-broking business. If steps are taken along these lines, there will be co-ordination between the indigenous bankers and the scheduled banks and through them with the Rserve Bank. In order to make themselves eligible for Reserve Bank facilities, indigenous bankers may organize themselves into discount companies operating within a given area. The Reserve Bank should be prepared to discount their paper when presented through such discount houses subject to the usual central banking principles.[10]

IV

CO-OPERATIVE BANKING IN INDIA

BY

Dewan Bahadur Hiralal L. Kaji

The economic progress of a nation can be best measured perhaps by the adequac and efficiency of its banking organisation. Prosperous agriculture, developed and developing industries, both large scale and small scale, extensive trade, both home and foreign, transport, cheap and quick, efficient and sufficient—all demand banking facilities for progress and prosperity. And it is not the individualistic personal system of the indigenous banker, the *shroff*, or the village money-lender. the *sahukar*, that will serve the purpose. It is organised banking that is wanted. where principles take the place of sentiment, where system replaces personalities, where a fair return replaces usury, where safety is ensured and risk minimised not by extravagant rates of interest but by scientific management and where economy and efficiency result from large scale operations. It is a well ordered, co-ordinated system of organised banking that is needed, sufficiently diversified and specialised to meet the requirements of different classes in the community, sufficiently spread out to place banking facilities within their easy reach and sufficiently capitalised to be able to dispense adequate finance. Judged in this way, we must confess to a feeling of disappointment when we realise that though the number of banks in India is apparently large enough and though of late it shows such an alarming increase as to have called forth Governmental restriction on new floatations and a Special Banking bill the banking organisation is inadequate for the vast and diversified needs of the country. The banking system as it has developed in India caters mainly to the need of trade only, and that too the home trade. Foreign trade finance has been neglected and has been allowed to remain the domain of Foreign Exchange Banks, which cannot naturally be helpful to the proper direction and character of foreign trade, which is the most vital of the agents of national prosperity and which is therefore today the main concern of international policies. Industrial finance has been severely left alone so far, and it is a remarkable testimony to the wonderful

suitability of India and the Indians that despite this glaring deficiency in her industrial structure, the lack of industrial banks, despite the consistent policy of industrial retardation of an alien Government, despite the lack of technical training and skilled personnel, and despite the shyness and inadequacy of capital resources, industrialisation has gone on apace and new industries have been established year after year.

Credit is required by all classes in the community. Producers want it for production; middlemen need it to avoid unnecessary cash payment for every transaction; and consumers need it too. Normally, the consumer as the final destination of commodities has to pay cash for what commodities he wants. If he cannot pay cash but usually needs credit, he is in a bad way and on the road to insolvency. But it may be that he is temporarily out of funds and needs accommodation to tide over a bad period and to that extent credit facilities may be desirable for him. The Joint Stock Banks in India came to be concentrated in large commercial centres; the smaller urban centres as also of course the rural areas were more or less completely neglected. Branches then came, though slowly. But even then, in a capitalistic banking institution, large scale operations are the rule; staff salaries, office rents, supervision and general expenses are fairly high and unless the volume of business is large enough, the opening of many branches is not possible. These banks and their branches serve the needs of commerce. But no facilities are provided for the producer or the consumer; and it is there that cooperative banki g has stepped in to fill up the lacunae in the banking structure of the country. The problem of the large producer, the industrialist, is a problem of industrial finance, and cannot well be solved by the comparatively simple methods and honorary agencies of a cooperative bank. The small producer however in villages, the agriculturist, the small producer in villages, towns and cities, the artisan and the consumer no less require banking facilities. These have nothing to fall back upon, no tangible security to offer, to obtain credit except the ability to produce or the ability to save. This ability to produce or to save, being largely incommensurable, is very difficult to assess and the ordinary commercial banks reject it as a factor of credit worthiness. Besides the transactions with small men being relatively small, large scale business is only possible by dealing with a larger number. This they find expensive and unremunerative; and they find it naturally more convenient to assess credit on commensurable factors and more economic to concentrate and

have large transactions with a small number than have small transactions with a large number. The small producer and the consumer are thus left unserved by Joint Stock Banking in India and it is only Co-operative Banking that can and has stepped in to undertake the great mission of financing the small man—the agriculturist, the artisan, the small trader and the thrifty consumer.

Co-operative Banking came in when the Co-operative Credit Societies Act was passed in 1904. In the last 40 years, it has had extensive developments and has played an important role in agricultural Co-operative Credit Societies—small rural banks, have become increasingly popular and on 30th June 1943 their number was 1,10,635 with a membership of 44,93,479 and a working capital of Rs. 29,08,46,991. This working capital of over Rs. 29 crores was made up of about Rs. 4·5 crores as share capital, Rs. 1·5 crores as deposits from members and Rs. 9 crores as Reserve and other funds, that is, of about Rs. 15 crores as owned capital and the rest, Rs. 14 crores, largely derived from loans by central financing agencies to the extent of about Rs. 13 crores, deposits from non-members being only about Rs. 1·3 crores. These lakh and ten thousand small Raffeissen banks are spread all over India, Bengal, having more than 36,000, Punjab more than 17,000 and Madras more than 10,000. The average for All-India of the number of societies per 1 lakh inhabitants was 42·2, Punjab having 92·4 societies, Bengal 67·5, Madras 29·9 and Bombay 26·3. Co-operative Banking has also developed at a rapid pace in Indian States with Hyderabad, Gwalior, Kashmir and Mysore, leading. The average size of the Bank is however larger in Bombay than elsewhere, the number of members for such society being 7? as against 68, 48 and 28 respectively in Madras, Punjab and Bengal respectively, and the working capital being a little under Rs. 8,000 per society, as against a little under Rs. 5,000, Rs. 3,300 and Rs. 1.700 in Madras, Punjab and Bengal respectively.

These small village banks in strict theory should be self-sufficient in finance, the deposits of substantial members being utilised to give loans to the others. The surplus of the thrifty should be available to meet the deficit of the needy in the village. But the well to do and the needy rather form distinct groups, the former playing or trying to play the *sahukar*. Thus instead of comprising more or less all sections of the population of the village, the society is rather made up of the needy section only, at any rate, very largely.

Even otherwise, the slender savings of the well-to-do would not be enough to meet the wants of the needy and the village society is not therefore able to be self-sufficient. It is creditable however that these village co-operative societies find about 50% of their own working capital ; they have to depend for the other 50% on outside agencies. The State, which came up in the early stages of the Co-operative Movement to bridge this gap, has however gradually receded and has practically faded out from the picture. Central Co-operative Banks were encouraged and Provincial Co-operative Banks as apex institutions were established to function as the Central Financial Agencies of the primary rural banks. These are outside creations finding finance for the primaries instead of their being evolved as District and Provincial Federations, but perform a very necessary function. They collect urban money for rural uses, and set up a counter-current for financial equilibrium, as a set off against rural and town money going up to large commercial centres *via* the commercial banks.

The area served by each Central Bank varies in different parts of the country. Generally, in Central, Southern and Western India, a revenue district is the area served by a Central Bank, while in eastern and northern India, the area is a sub-division of a district—a tehsil, so that the area served by a Central Bank in Bengal, Bihar, U. P., and the Punjab is smaller than elsewhere, the number of societies served by each is smaller, the working capital is smaller and the cost of management is comparatively higher. Out of the 5[illegible]1 Central Banks in India on 30th June 1943, 121 were in Bengal, 120 in Punjab, 69 in U. P. and 49 in Bihar. Madras had 30 and Bombay only 13. The working capital of these Central Banks was a little under Rs. 30 crores, out of which share capital accounted for Rs. 2·[illegible] crores, Reserve and other funds for Rs. 4·6 crores, deposits by societies for Rs. 3·7 crores, deposits by individuals for Rs. 14·3 crores, loans from the Provincial Banks for a little under Rs. 4 crores and loans from Government, chiefly in the Indian States, for about Rs. 0·[illegible]6 crores.

These Central Banks have done very well indeed and may generally be classed as successful banking institutions of the Co-operative Movement. Local leadership creates confidence and the flow of deposits from the urban areas of the tehsil and the district is often so great that the Banks are faced with the problem of finding

suitable avenues of investment for their surplus funds—funds which cannot be absorbed within the Co-operative Movement. Lending to individuals is usually denied to them and investment in Government securities is often the only course possible. With the great developments that are now in the course of shaping, particularly in the sphere of co-operative marketing of agricultural produce, the utilisation of the so-called surpluses within the movement will probably be found possible. These central banks confine themselves into the field of intermediate term finance. But long term finance is not possible with short term deposits and special banks, the land mortgage banks, have had to be started to meet this credit need of the agriculturist. Central Banks continue to be the bulwark of the Co-operative Movement and on their efficiency depends to a large extent the success or otherwise of the village banks, financed, inspected and to some extent supervised by them.

The logical development of central co-operative banking has been establishment of Provincial Co-operative Banks. There are 11 such banks in India, including those for Mysore and Hyderabad. Of the Indian Provinces, only Orissa has not so far organised a Provincial Bank but it is already planning to have its own Provincial Bank. These banks serve as apex organisations and as balancing centres for the Central Banks, so that seasonal local deficits of some banks may be met from the surpluses of the others. Obviously a further development of Central Co-operative Banking seems clearly indicated and an apex All-India Co-operative Bank should have been established. But an Indian Provincial Co-operative Banks' Association has already been formed and serves a useful purpose indeed by functioning as a clearing house for information, consultation and concerted action. Besides, the Reserve Bank of India has an Agricultural Credit Department and renders important services in the discounting and rediscounting of co-operative paper, and in undertaking very useful investigations and researches which throw very clear light on co-operative practices and suggest guidance for the future.

The Provincial Banks had a working capital on 30th June, 1943, of over Rs. 14·5 crores. The share capital was a little less than Rs. 0·8 crores, the Reserve and other funds amounted to a little under Rs. 1·5 crores. Government has not had to actively assist in

the financing of these institutions at all, except recently in Bengal and Bihar where the process of consolidation, rectification and rehabilitation of the Co-operative Credit Movement made it necessary to the extent of Rs. 0·7 crores. The bulk of their finance was obtained from deposits—those from individuals amounting to over Rs. 6·25 crores and those from societies and central banks amounting to over Rs. 5·25 crores. The C. P. and Berar Provincial Bank came in for some difficulties owing to grave troubles in the Central Banks financed by it but is now coming round well. Indeed, generally speaking, the Provincial Co-operative Banks are excellent examples of efficient banks worked on co-operative principles and form the pivotal base from which the movement derives its strength. Deposits from the public come in freely despite the competition of commercial joint stock banks in the provincial capitals, the management is efficient and service satisfactory. These have years of experience behind them and would have grown into much larger banks but for the fact that their operations are mostly confined to co-operative societies, largely central, and that the surplus funds cannot be used for granting loans to individuals nor can they be invested in channels which are open to the ordinary commercial joint stock banks. With the growth of co-operative marketing, it is very probable that a more profitable use within the movement would be available for the funds of these Banks, giving them further scope to accept more deposits.

Co-operative Banking in India, largely identical with agricultural finance, has thus three sections—the village bank, supported by the Central Financing Agency at the tehsil or district headquarters, and buttressed by the Provincial Bank at the provincial capital. It is now an integral part of the co-operative banking system in the country in so far as the Reserve Bank of India at the head of the system through its Agricultural Credit Department assists the Provincial Banks by giving to them discounting and rediscounting facilities.

The loans advanced by co-operative societies to their members and by the central financing agencies to their constituent societies, are, from the very nature of the source from which they derive the bulk of their finance, for short or intermediate terms only, and are only meant to be useful and fruitful for the current needs of agriculture. Loans for redemption of old debts and loans for land

improvement have necessarily to be for longer periods and yet these are most important in the reorganisation of agricultural economy in the country, so that resort to the *sahukar* may not be necessary and old debts may be liquidated after suitable scaling down under the various measures adopted in the different provinces and the earning power of the cultivator may improve with the improvement of his land with the proper application of larger loans, the repayment of which is spread over a long term of years. To meet this need, land mortgage banking on a co-operative basis has been introduced comparatively recently.

There are 271 land mortgage banks and societies in India, of which 120 are in Madras, and 67 in Mysore. Bombay has 18 and Central Provinces and Berar have 21. Their working capital on 30th June, 1943, was a little over Rs. 7·75 crores, the most important constituents of which were loans from other Banks and societies, amounting to about Rs. 3·25 crores and debentures amounting to a little under Rs. 3·75 crores. Share capital and Reserve and other funds are relatively unimportant being less than Rs. 0·5 crores and Rs. 0·25 crores, respectively. Madras and Bombay each has a Provincial Central Land Mortgage Bank, which is the chief collector and dispenser of funds through the primary land mortgage societies under it. Land Mortgage Banking has not yet proved popular nor can it be said to have lightened the burden of indebtedness or improved the economic position of the cultivator materially. It is still in the nature of an experiment. The high prices of agricultural commodities during the war and in the post-war period and the extraordinary rise in the price of land have however been factors of considerable significance. The cultivator has shaken off the bulk of his debt in many cases by even selling off a plot or two from his holding if necessary and he now does not feel inclined to apply for a loan from the Land Mortgage Bank. Applications for loans for land improvement have always been very few and now when applications for loans for redemption of old debts have also fallen off, the problem of the Land Mortgage Banks becomes serious indeed.

Co-operative Banking though most conspicuous in rural areas is by no means confined to those areas. Urban co-operative banking is concerned with the small consumer, the small producer and the small trader, for it is these elements of the urban population that are ignored or neglected by the commercial banks, and demand banking

facilities from co-operative institutions. So far the problem of finance for artisans has not been earnestly tackled, nor are the small traders served any very effectively. The bulk of co-operative endeavour in urban areas has been in the realm of providing credit facilities to the small consumer. Ordinarily, the consumer should need no facilities for credit ; and yet, the Urban Co-operative Credit Society is an absolute necessity to him. It saves the smaller wage earner from the clutches of the professional money lender, into whose arms the present capitalistic system of banking would consign him ; it helps the thrifty man to invest his small savings ; it helps the unfortunate to tide over a crisis ; and it preserves his self-respect.

There is no uniform basis for classifying these urban organisations as credit societies or as banks. In Bombay and Sind, urban credit societies having a paid up share capital of Rs. 20,000 and over and doing banking business are termed urban banks. In Madras, the paid up share capital is not taken into account, but the test is the acceptance by them of deposits on current account and maintaining adequate fluid resources. In many other provinces, no distinction is made and all urban credit societies are termed urban banks, irrespective of the size of the share capital or the nature of deposits accepted by them.

There were on the 30th June, 1943, 7093 urban credit societies, of which 71 in Bombay and 154 in Madras are accepted as urban banks. It is a pity that statistics are not available separately for these urban credit societies as distinguished from urban non-credit societies, the figures for both these types being presented together as for non-agricultural societies. The total working capital was about Rs. 34 crores, made up of share capital—over Rs. 7¼ crores, Reserve and other funds—over Rs. 4½ crores, deposits from members —about Rs. 10¾ crores, deposits from non-members—over Rs. 8½ crores, while loans from Central and Provincial banks amounted only to a little over Rs. 2 crores. Loans made during the year 1942-43 amounted to about Rs. 14¾ crores and these transactions must be taken to relate to urban banks only or at any rate largely. Co-operative Urban Banking has made excellent progress in Bombay and Madras. In other parts of India, there are merely urban credit societies and co-operative banking as such is practically non-existent. But it is recognised that the success of urban co-operative banking is the one bright spot to which co-operators in India can turn for strengthening their faith in the co-operative ideal, weakened so largely by the continued lack of success in rural areas.

The urban credit societies and banks resolve themselves into four types :—(i) The Salary-earners' Society ; (ii) the Millhands' Society ; (iii) the Communal Society ; and (iv) the Peoples' Bank. The *Salary-earners' Societies* have been generally organised on the occupational basis, the members being employees in the same firm or Government office. The strength of a society of this type lies in the absence of communal jealousies and factions, in the higher level of culture and intelligence of the members and the spirit of discipline that prevails in a modern well-conducted office ; the weakness lies in the facts that such a society avowedly exists to meet the needs of the consumer, whose salvation really lies not in borrowing but in greater earnings. A great accretion of strength accrues to the society from the sympathy of the employer or head of the office, so that recoveries of instalments of loan repayments are usually arranged from the pay sheets and the dangers of overdues are practically eliminated. The *Millhands' Societies* are more or less of a similar type, the difference lying chiefly in the illiteracy of the members, in their smaller transactions and in the possibility of the whole organisation being wrecked to pieces when the millhands down tools. Recoveries through the wage bills and constant supervision by a trained and reliable Superintendent paid by the employers for a group of such societies the Labour Officer, are very necessary for their safety and success. Trade unionism, welfare work and co-operation are very closely related. The trade unionist having secured due wages, hours of work etc., the welfare worker having secured good and human conditions of work, it is for the co-operator to step in and see that men's life outside the factory is spent as happily as could be. The one begins, the other follows up and the third puts the finishing touch. The employer must therefore learn to welcome the first, finance the second and to contribute to the third. The class consciousness and the spirit of independence of the one, the humanising touch of the other and the spirit of self-reliance, thrift and mutual help of the third—all these are needed for good to blossom out of a comprehensive labour policy. The *Communal Bank* represents in theory a very strong type but in practice a very weak society in general. Members know one another ; they have the communal bond between them ; but precisely because of these, considerations alien to the business of the society a factious spirit pervades the proceedings, and personalities and sentiments dominate the situation. Loans are sanctioned, which ought not to

have been sanctioned; defaulters are not quickly haulded up; arbitration proceedings are most reluctantly taken; awards are not promptly executed. The purpose of the loan is usually unproductive and repayment of loans becomes a very difficult affair. The *Peoples' Banks* on the Luzzalti model are excellent little banks and represent the best type of urban co-operative banking. Such a bank is open for membership to all residents within a particular area and aims at financing the small trader and the small artisan, so that the loans are for productive purposes. A trained and adequate staff guided and controlled by a watchful directorate, and a large size of the share capital and therefore of the working capital are necessary factors conducive to success. Indeed, Peoples' Banks do not differ materially from an ordinary joint stock commercial bank except in their recognition of personal credit, in their adoption of the principles of distributive justice in the distribution of profits and their comparatively smaller size. For the growth of banking in the smaller areas, talukas and tensils, there is nothing so promising as Peoples' Banks.

In the forty years and more, co-operative banking has made very great progress indeed, both in rural and urban areas. That the success achieved is not so commensurable, that the purpose, the economic regeneration of the masses, is not any nearer its fulfilment, have depressed the workers, officials and non-officials. The causes are not far to seek. Co-operation has become a Government Department; and that too a small department. The state accepted co-operation but did not enthuse over it and was not keen. National leaders did not associate themselves with it, because it was a Government policy and not a peoples' movement. The beneficiaries were illiterate, ignorant, helpless and listless. The honorary workers were looked down upon as hunters after three H's—Honour, Honours and Honoraria. It was never clearly recognised that a rural co-operative society is as much a business concern as any other banking or trading institution can be. Loose management, low paid, inefficient or honorary staff for directional and even for routine day to day work, too small a scale of operations, too much spoon-feeding, inordinate desire for concessions and privileges, have unfortunately so clogged the working of these societies that co-operative management is often referred to as an antithesis to efficient business management. Unbusinesslike methods are however not an attribute of co-operative economics but an accident due largely to small scale

operations, honorary management and Departmental control. Indeed honarary management in co-operative institutions is at once the greatest asset and the gravest danger to success ; wise direction by the Department and development of an internal non-offiial supervisory agency and not increasing control by the Department are the needs of Movement. Too much spoon-feeding weakens the sense of responsibility. Over-anxiety and too ready assistance cannot evolve the spirit of self-help which is the fundamental basis of success for any co-operative concern. Even urban co-operative banking has been dwarfed and stunted by mistaken restrictions suggested by misapplied analogies with rural societies. The two areas are so distinct, the populations affected are so dissimilar that what might be an excellent stimulant for one might be an unnecessary depressing narcotic for the other, what might be nutritious to the growth of one might conceivably be deleterious to the development of the other.

Apart from these elements of weakness in Co-operative Banking in India, particularly in the rural areas, it must be recognised that most of the societies had, as members, only loan hunters and not depositors; there was no very careful selection of members; the unprovident and the unthrifty, the drifters and the weaklings came together. Unlimited liability, the great asset of a Raiffeisen Bank and its great weapon to enforce a close scrutiny of loan applications and watchful supervision over the application for loan for productive purpose specified in the application, scares away the substantial elements in the village and only brings together those whose unlimited liability is but pitifully limited.

Whatever the shortcomings and weaknesses in the past, there is no doubt that Co-operative Banking has a very bright future indeed. India now independent and it is impossible for a National Government to be lukewarm about ccoperation since there is no doubt whatever that in cooperation lies the best hope of rural India. Debt legislation in various provinces results ever more and more in increased recourse to the co-operative society for crop finance and to the land mortgage bank for long term finance. It is further definitely being recognised that for the economic regeneration of the agriculturist, mere credit institutions are not enough. Small scale industries as subsidiary occupations will have to be developed and fostered and these will need funds. Even now and more so when agriculture becomes more intensive, Co-operative Marketing is on the

threshold of development and marketing finance will be more than ever necessary. The scope for development of Co-operative Banking is therefore very great, for crop finance, for land improvement finance, for marketing finance and for industrial finance. In the great programme of expansion and diversification of the Cooperative Movement, we can clearly see vast scope indeed for developments in Co-operative Banking on right lines, both in the village, the town and the city.

V

LAND MORTGAGE BANKING IN INDIA

BY

Krishna Kumar Sharma

It is now an admitted fact that the most suitable agency for supplying the long term financial requirements of the cultivator is the land mortgage bank. The Indian Central Banking Enquiry Committee[1] classified such banks into three catagories: cooperative, non-cooperative, or quasi-cooperative. The cooperative type is represented by the Prussian Farm Mortgage Mutual Credit Associations which are associations of the borrowers without capital. They do not aim at profit and their rate of interest is low. Their expenses are met from the income of enterance fees paid by the members. Mortgage bonds are used to raise the necessary credit. These Landschaften are combined into a Central Landschaft which is a central cooperative organisation. The Federal Farm Loans of America also belong to this type. The non-cooperative type is represented by the joint stock land mortgage banks which exist in European countries. They work for profit and they are subject to State control so that hardship may not be caused to borrowers. The French model of Credit Foncier de France and the Agricultural Bank of Egypt belong to this type. The Agricultural Mortgage Corporation which was set up in England in 1928 to give long term loans to land-owners at a moderate rate of interest also belongs to this type. Its funds are drawn from its registered capital amounting to £650,000, bonds carrying a Government guarantee of about £11,000,000 and Treasury advances up to a total of £750,000. Other institutions are of a quasi-cooperative character. They are associations with membership of borrowers and non-borrowers operating over large areas having a share capital and limited liability. The Hungarian Land Mortgage Institute for large land-owners is an example of this type. M. Louis Tardy in his book, *Systems of Agricultural Credit and Insurance* has given an account of these institutions in the monographs attached to the book. Prof. Anwar Iqbal Qureshi has given an account of the working of State banks in various countries of the world. In that book he has advocated the opening of State banks in India with a network of bran-

[1] Para 198 of the Report

ches as in his opinion the existing type of cooperative land mortgage banks cannot solve the problem.[2] In the opinion of Central Banking Enquiry Committee the commercial land mortgage banks were regarded as suitable for financing big landlords, while the cooperative type was recommended for small agriculturists and for owners of small holdings.[3]

Brief Historical Retrospect

The existing land mortgage banks in India belong to the cooperative type. Attempts were made in India as far back as 1883 to provide financial facilities when the Land Mortgage Bank of India was started on the model of the Credit Foncier de France; but the bank could not succeed because of over-investments without the necessary safeguards.[4] A land mortgage bank was registered on 30th June, 1920, at Jhang in the Punjab but it has had a chequered history. On 31st July, 1942, it had 319 members and a working capital of Rs. 1,36,000. The total amount of loans due from members was over a lakh of rupees. The bank was in a moribund condition. The number of land mortgage banks in the Punjab in 1929 was 12 but on the eve of the last war all banks excepting one or two in the province were really under voluntary liquidation. A real beginning in land mortgage banking was made with the establishment of the Central Land Mortgage Bank in Madras in 1929 on cooperative lines. Since then cooperative land mortgage banks have been organised in other provinces also. In Madras, Bombay, and Mysore central land mortgage banks have been set up to finance and coordinate the working of primary land mortgage banks; but in the Central Provinces and Bengal separate departments of the Provincial Co-operative banks look after the work pending the organisation of apex banks for these institutions. In Orissa the provincial land mortgage bank has been financing agriculturists direct through its branches. In other provinces the movement is in an undeveloped state.

Out of 266 primary banks in 1942 in India, Madras with 119 is by far the most important, followed by Mysore with 65, C. P. with 21, Bombay with 17, Ajmer-Merwara with 12, Punjab with 10, Bengal with 9, and U. P. with 5. Finance has been raised through debentures carrying a guarantee of the Provincial and State governments conce-

[2] Read Proceedings of the Fourth Conference of the Indian Society of Agricultural Economics, Bombay, 1943, pp. 184 to 194 of the Report

[3] Page 155 of the Report

[4] Page 166, Proceedings of the Fourth Conference of the Indian Society of Agricultural Economics Bombay, 1943

rned. The total debentures of the various banks outstanding on the 30th June, 1942, amounted to Rs. 359.77 lakhs of which debentures worth Rs. 273.95 lakhs were outstanding. In Bombay and C. P., no debentures had been redeemed. The total loans outstanding in primary banks at the close of 1941-42 amounted to Rs. 3,77,20,594, of which banks in Madras were responsible for Rs. 2,63,78,791.

Main Features

The working the land mortgage banks in India is characterised by certain features given below :

(1) The advances have been made so far almost entirely for redeeming past debts, although under the by-laws they are allowed to make loans for land improvement and to purchase land for rounding off holdings. In 1937 the Agricultural Credit Department of the Reserve Bank of India made an enquiry into the working of land mortgage banks. Replies were received from 43 banks which showed that loans for liquidation of old debts formed 98% of the total advances as against 38% advanced for land improvements. Other banks from which replies were not received had not advanced any loan for objects other than the liquidation of old debts. Taking into account all-India figures the percentage of advances for liquidating past debts would be higher.

(2) Loans are made to the agriculturists against the security of first mortgage of agricultural land of at least twice the value, repayable in 20 years in equated annual instalments. The borrower can make repayment earlier and he cannot further encumber the land without the consent of the bank. The rate of interest varies between 6 and 7 per cent.

(3) The maximum amount that can be lent to a member is Rs. 10,000 which in some banks has been reduced to Rs. 5,000. The minimum limits are about Rs. 300.

(4) Funds are raised mainly by debentures and also by selling shares. The borrowers are required to subscribe to the share capital an amount equal to 5% of the borrowings. Debentures are guaranteed by the Provincial Governments regarding principal and interest and their period of maturity varies from 20 to 25 years.

Governtment Help

The Government have encouraged these banks in a number of ways. Debentures have been guaranteed. Subsidies have been

granted. In Orissa the Government have taken up a part of share capital. Exemptions have been given from stamp duty, registration fees, etc. Great control is exercised over them by the Government which has appointed the registrar of co-operative societies as the trustee of the debenture-holders. He is also the Ex-officio member of the Board of Directors. Valuation of land is done by Government officials whose services are given free to the banks. In Madras, C. P. and Berar and certain other provinces, special Land Mortgage Acts have been passed. In other provinces the Co-operative Societies Acts have been amended. Special powers have been conferred upon these banks in respect of recovery of loans from defaulters.

Effect of War

The last war affected their working in many respects. In the beginning land mortgage banks experienced difficuties in floating debentures but subsequently they could easily float them on favourable terms. The Madras Central Land Mortgage Bank floated debentures at 3% in August 1942. It was equal to the yield on Government paper of the same duration. Table II, facing page 50, prepared from the Annual Report of the Registrar of Co-operative Societies indicates the effect of the war on their working.

The effect of the war on the working of land mortgage banks shows a fall in advances from Rs. 55·08 lakhs in 1941-42 to Rs. 38·23 lakhs in 1942-43. Total recoveries increased from Rs. 36·04 lakhs to Rs. 55·50 lakhs. The amount of outstandings fell from Rs. 8·93 lakhs to Rs. 6·9 lakhs ; while deposits increased from Rs. 16,93,44 to Rs. 2039·74 lakhs. Actually the new business of land mortgage banks has fallen. There has been a rise in the value of the produce and of the land. The credit of cultivators has gone up. Agriculturists are able to pay off their old debts owing to the increased income or in some cases by selling land at high prices. There are advance payments also. Thus so long as these institutions continue supplying loans for liquidating old debts, there are limits to the expansion of their business.

Defects in Working and Suggestions for Reform

Table III, facing page 50, and Table IV on page 53 indicate the operations of central and primary land mortgage banks in India for 1941-42.

Operations of Primary Land Mortgage Banks in India, 1941-42

Provinces	No. of societies	No. members	Loans advanced during the year	Loans outstanding at the end of the year	Loans overdue	Owned funds	Borrowings	Profits
			Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Madras ...	119	69,158	40,40,114	2,63,78,791	1,10,950	22,58,102	2,59,93,030	1,34,576
Bombay ...	17	13,621	5,58,398	33,31,203	89,992	4,08,221	31,93,031	16,607
Bengal ...	9	2,769	34,120	6,56.056	43,455	65,746	6.14,962	2,350
Orissa ...	1	657	55,778	1,34,813	...	68,207	1,00,000	3,875
U. P. ...	5	838	46,013	2,02,956	11,674	43,865	1,70,921	5,082
Punjab ...	10	3.943	93,271	9,28,848	5,73,272	1,74,224	10,83,778	30,650
C. P. & Berar ...	21	6,788	6,15,924	15,76,859	91,414	1,41,223	14,55,473	15,001
Assam ...	4	1,767	3,850	2,30,850	2,26,363	1,69,871	2,13,204	11,304
Ajmer Merwara ...	12	1,221	9,457	89,631	1,398	9,387	75,335	334
Mysore ...	65	8,531	3,61,765	15,73.387	6,848	1,93,380	15,75,522	21,717
Baroda ...	2	2,293	1,45,525	7,87,490	474	2,34,744	6,66,475	25,023
Cochin ...	1	2,575	2,74,759	18,29,700	26,655	1,21,977	17,86,705	18,450

The tables indicate the slow progress of land mortgage banking in India. We may judge the progress from any point of view, the number of banks, the number of members, loans granted, owned funds or profits—all tell the same tale We have to find out the reasons therefor and suggest the necessary remedies in the light thereof. In many cases the working is inefficient. As a general rule, the directors of primary land mortgage banks lack the necessary initiative. The income of the banks is not sufficient to enable them to have an up-to-date organisation. The main source of their income is the difference between the rate paid by them to higher institutions and the one at which they make loans to agriculturists. This is insufficient to employ even the necessary staff. In some provinces the method of appointing land valuation officers is such that it is not possible to have an experienced land valuation staff. Clerks of the co-operative department with a month's training or so in the land valuation work are appointed as land valuation officers. In this connection the Government should come to their rescue by meeting some of these expenses.

The success of land banks depends upon accurate land valuation and the determination of the annual repaying capacity of the borrower. Instalments should be punctually recovered, failing which land banks may not be able to obtain the necessary funds through debentures. These defects can be removed by keeping suitable staff. Further there is much scope for improvement in respect of raising funds by debentures. They have been able to float debentures at low rates because of Government guarantee and because they are declared as trustee security. What is necessary is that their working should improve so that the investor should have confidence in them and their debentures may find an easy market. In this connection the advice of the Reserve Bank of India should be sought for and there should be greater liaison between these banks and Reserve Bank of India. This topic will be presently referred to.

Another defect in their working is that they concentrate too much on the redemption of old debts and too little with the improvement of land and agriculture. This has been alluded to above. Of course to a certain extent in the existing conditions in India it is inevitable, but efforts should be made in order that land mortgage banks may pay attention to questions of granting loans for agricultural and land improvements to a greater extent than has been possible hitherto. This would require close co-ordination between

the land mortgage banks and the Agricultural Department. The latter should advise the agriculturists on improvement schemes which would then be fit objects for granting loans for land and agricultural improvements. In this connection the recommendation of the Thirteenth Conference of Registrars was that land improvement loans should be advanced at a lower rate than loans for other purposes. Ordinarily they should be given in consultation with Agricultutal and other Deparments. Land mortgage banks can also do much to promote schemes of consolidation of holdings, particularly where fragmentation has reached a very bad stage. They should develop other lines of business than merely granting loans for repayment of old debts in order that they may become minimum economic working units. Many reasons have been given for the small amount of loans granted for land improvement, viz., heavy indebtedness of borrowers, provisions in the bye-laws requiring repayment from the very first year, absence of the necessary organisation for supervising the use of such loans and absence of scope in this respect in a country of small holdings. As a matter of fact, land mortgage banks can prove of great assistance only if they concentrate on the wide range of agricultural operations relating, inter alia, to drainage, reclamation of land, promotion of rural industries and similar other matters. Land mortgage banks can particularly help in providing funds to facilitate exchanges of land on requiring payment of money and by giving concessions in loans to those who have consolidated their holdings There is great need in some places for providing better irrigation facilities and for purchasing agricultural machinery. Prevention of soil erosion is another important matter requiring considerable finance. Consequently detailed investigation is necessary in regard to the ways in which agricultural improvements can be done.

During the war cultivators have been anxious for purchase of land but in many places they have been handicapped on account of the lack of finance. The money-lender has been unwilling to lend money for this purpose on the security of land because of the effect of the money-lending legislation in different provinces. The existence of land mortgage banks facilitating the purchase of land by the cultivators should be a great advantage. They should grant loans for about 50 to 60 years at low rates of interest so that the cultivator may be enabled to purchase land. This has been done in other countries. Some efforts are being made in Bombay and

C. P. to encourage loans for land improvement. But perhaps adequate success has not been achieved. Rules have been made by the Central Land Mortgage Bank of Madras to provide loans for constructing irrigation works and for similar other purposes. The Registrars' Conference of 1926 recommended that the principal objects of land mortgage banks should be:—

(a) The redemption of land and houses of agriculturists,

(b) The improvement of lands and methods of cultivation and the building of houses of agriculturists,

(c) The liquidation of old debts,

(d) The purchase of land in special cases to be prescribed in the bye-laws.

The Royal Commission on Agriculture found themselves in substantial agreement with the views of the Registrars' Conference of 1926. The Indian Central Banking Enquiry Committee[5] suggested that loans made by land mortgage banks should be devoted to the redemption of land and houses of agriculturists and the liquidation of old debts, to the improvement of land and methods of cultivation and the construction of houses of cultivators, and to the purchase of land in special cases. It will be noticed that both the Registrars' Conference and the Central Banking Enquiry Committee put the financing of land purchase through land mortgage banks in the end in order of precedence; but in future the abolition of the zamindari system should lead to the financing of land purchase to a great extent and this object consequently should get precedence over others as a method of land reform.

The purpose of the redemption of old debts can be served better if the operations of debt conciliation boards are co-ordinated with those of land mortgage banks. The reduced amount of debt should be paid to the creditor in cash by a land mortgage bank, which can realise the amount in instalments from the debtor. The prospect of cash payment might induce the creditor to agree to a greater reduction in his claims than payment in instalments over a number of years. The experience of attempts at co-ordination in C. P., Madras, and Bengal has not been encouraging. The instalments fixed by the Debt Conciliation Boards carry no interest.

Consequently debtors have preferred to pay these instalments to the alternative of borrowing from the land mortgage bank on interest

[5] Page 168 of the Report

to pay off the conciliated debt. They have not been in favour of assuming a definite obligation to be rigidly enforced. Naturally they have held out in the hope of further relief through legislation. The banks also have not advanced loans in some cases because intending borrowers could not offer adequate security. Creditors too have been unwilling to further reduction in their claims in return for cash payment. These difficulties have prevented the effective liaison between the machinery of the conciliation boards and land mortgage banks. In this connection the Bombay Agricultural Debtors' Relief Act, 1939, provides that if before the award the creditors reduce the debts to half the value of the debtor's immoveable property and remit the rest, they may be paid in bonds issued by the provincial Land Mortgage Bank and guaranteed by the Provincial Government. The amount of bonds is to be recovered as an arrear of land revenue. Such provisions should secure proper co-ordination between the conciliation boards and land mortgage banks. But as a result of the wartime rise in the income of the cultivators, such provisions may not be necessary for some time to come.

There should be proper coordination between the land mortgage banks and other cooperative organisations in order that land mortgage banks may be able to maintain contact with the borrowers. The debts of members could be paid off out of a loan from the land mortgage bank. The short term finance can be supplied by the society and the sale of the produce of members could be done co-operatively through a marketing society. The instalments of the land mortgage bank and the loans of the society could be regularly paid and thus better cooperation should be ensured between land banks and cooperative banks. In such cases the cooperative society should have a first charge on the crop.

It may be pointed out that during the war the problem with the land mortgage banks was not lack of funds but there was no demand for them. Unfortunately, no recent figures are available in this connection, but the figures regarding loans made in 1941-42 as compared with those for the previous year substantiate this contention. The total loans repaid to them in 1941-42 were Rs. 65,63,528. The corresponding figure was Rs. 1,14,07,513 in 1940-41.[6] The problem, therefore, is that there is no demand for funds. The question is how to create the demand. Perhaps the fault may lie with the loan machinery of these banks which is

[6] Statistical Statements relating to the Cooperative Movement in India, 1944

cumbrous and full of red tape. Consequently there are obstacles in the way of the borrowers. They must be removed.

Reserve Bank Of India & Land Mortgage Banks

Something may now be said about the relationship between the Reserve Bank of India and the land mortgage banks. The Reserve Bank authorities have discussed this topic in the Statutory Reports and in certain circulars in which their views are embodied. It has been pointed out therein that the Bank cannot lock up its funds in the debentures of the land mortgage banks until their ready marketability is proved. It is prepared to give them advice through its Agricultural Credit Department. It has suggested that they must grant loans for permanent improvements. The Agricultural Credit Department should give technical advice to the land mortgage banks regarding land improvement finance and should supervise the use of their loans. In areas selected by land mortgage banks for allowing land improvement loans, the Government should discontinue Taqavi loans. The Statutory Report proposed to deal with the subject in a separate bulletin which has not yet been published.

The Reserve Bank can help the land mortgage banks particularly in two ways. It can accept debentures of the central land mortgage banks guaranteed by a Provincial Government as security for advances under section 17 (4) of the Reserve Bank Act to increase their popularity. The view of the Reserve Bank is, however, different. In a letter written by the Bank to the Government of Madras in August 1940 and marked confidential, the Bank pointed out that if it treated the guaranteed debentures on the same footing as government loans, the proportion held by the public would increase; but the gulf between the guarantee and non-guarantee status would be widened and the government would not be able to discontinue this guarantee. The suggestion of the Bank is that interest on debentures should be charged from agriculturists. The Bank also suggested as an alternative that the government might grant a straight loan to the land mortgage banks and the guarantee may be dropped as a temporary measure and these requirements may be included in the ordinary loan programme of Provincial Governments.[7] There is no reason

Also see article on Land Mortgage Banks by Sher Jung Qhan, pages 214,215, Proceedings of the Fourth Conference of the Indian Society of Agricultural Economics.

why the debentures of cenrral land mortgage banks should not be accepted as security for advances under section 17 (4) of the Reserve Bank Act. The Reserve. Bank Act may be amended so that the Bank may undertake the floatation of the debentures of land mortgage banks. It will help them in providing finance to a great extent.

Secondly, a Long Term Mortgage Department must be attached to the Reserve Bank of India on the lines of the Long Term Mortgage Department of the Commonwealth Bank of Australia. The suitability of creating such a department should be examined. It can grant long term loans to the land mortgage banks and it can also help in floating their debentures.

The creation of land mortgage banks on adequate scale is very necessary to improve the agricultural economy of our country. Measures of far reaching importance in respect of land reform are to be undertaken in our country. The U. P. Government has decided to abolish the zamindari system The Bombay Planning Committee also advocated reform of the land system.[8] In any scheme of land reform involving the abolition or modification of the zamindari system, the cultivator would have to be given proprietory rights; while landowners will have to be paid adequate compensation for extiguishing their claims. This could be facilitated through a net work of land mortgage banks, assisted by the state if necessary. They can make the payment to the landowners either in cash or in debentures issued on the security of land given to the cultivators. In this way this programme of land reform can be finenced through land mortgage banks.

It is necessary to appoint a committee of experts to consider the question of improvement in the working of land mortgage banks in our country. Special Land Mortgage Acts should be passed in every province to provide facilities for them. The debentutes of these banks should be guaranteed by the provincial governments. Liberal financial state assistance can be given to them. The Reserve Bank of India should also extend help to them in the ways indicated above. The money-lender should be brought within the orbit of land mor-

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[8] Page 16 of part II of the Bombay Plan

tgage banks and Mr. Manu Subedar's suggestion of making the village money-lender a guarantor to attract funds deserves consideration.[9] It will then be possible for land mortgage banks to work successfully in our country and they will be of real assistance in improving our agricultural industry.

VI

FOREIGN EXCHANGE BANKING IN INDIA

BY

B. S. Audholia

The history of foreign exehange banks in India is inextricably linked up with the history of India's eeonomic penetration by Britain. It is only too well known that India was laid under a ceaseless economic onslaught ever since the advent of the British East India Company. As a matter of fact, the whole of our economic life was kept under a systematically planned attack by the alien rulers. In the domain of foreign cxchange banking, foreign bankers were allowed a free entry and unfettered expansion. The result was that they soon rose to power. The indigenous bankers[1] that handled the foreign business were completely wiped out in no time. Soon after the unlimited copartnership (Anglo-Indian) banks that were started between 1829 and 1845 to handle this business were also outdistanced and outstripped. Thus the foreign exchange business became a monopoly of foreign bankers. This monoply they still enjoy althongh attempts were made towards the close of the British Period by the Indian banks to take an increasing share in this business. But oft-repeated resentment of the Indian Chambers of Commerce, the opposition of the nationalists, the efforts of the Indian banks and the counsels of the Reserve Bank, all proved powerless to improve the situation. Today also their monopoly stands almost substantially in tact.

The importance of foreign exchange banks to a country's economy depends upon the extent of her foreign trade. Judged from this standard, foreign exchange banks have great importance for India because the aggregate value of India's foreign trade has been normally high. It is true that there have been some occasional set-backs, but they have never seriously jeopardised the importance of her foreign trade for any length of time. Even during the stress of the World War II when exchange controls and import restrictions

[1] Until 1796-97, the governments of the provinces always entered into contracts with the indigenous bankers for securing funds in the different centres to finance foreign business. (vide *Government Manuscript Records*, Imperial Record Office, the 7th January, 1800, No. 47.)

became necessary, her foreign trade did not record any distressing effects. After the loss of European and far Eastern markets, she built up valuable trade connections with Russia and non-empire countries notably Iran, Iraq and Egypt. The prospects of this trade as also our trade with the East African colonies and the Middle East are bright. We have to make serious efforts to ensure that this growing volume of our foreign trade is financed through the medium of our national exchange banks to an ever increasing extent.

This brings us to the consideration of the ways in which foreign bills are drawn and negotiated. Roughly speaking these can be arranged under four heads:[2]

(i) Imports and Exports

(ii) Gold and Silver

(iii) Invisible Trade

(iv) Capital Movements

The exchange bark is the product of the modern system of international organisation. Therefore, it follows that when goods, bullion, ssrvices and capital movements take place between different countries, its services become essential. Its profits are thus the result of the services that it renders and they arise out of the purchase and sale of the 'rights to foreign curtency'. This is done principally through the bills and the letters of credit. The whole thing is arranged under various 'kinds of exchanges' that vary according to the urgency for purchase and sale of different currencies.

The import bills are of two kinds : (a) with documents against aeceptance, and (b) with documents against payment. They may also be classed as (i) bills against credits and (ii) bills for collection. In India the imports are usually financed through either (i) 60 days sight D. P. drafts drawn on the Indian importers or (ii) London Banks' aceeptance of house paper. In the first case, the D. P. drafts are collected by Exchange Banks from importers or their representatives. In the second case, the London exporter draws a bill on the London office of a foreign bank, which accepts the blll. Thus the drawer is enabled to discount it in the London Money Market.

[2] Sometimes exchange banks also indnlge in pure exchange speculations. For our purposes, however, they are not important, for they depend on wide conjectures for happy hits.

The accepting bank sends the relative documents to its branch in India for collection of the proceeds from the foreign office of the exporting firm and thus a remittance is arranged to London on or before the maturity of the bill. Both kinds of bills or instruments are drawn in sterling. In the first case, interest is payable at 6 p. c. from the date of the bill to the date of the arrival of funds in London. In the second case, the bill is discounted at a lower rate in the London Money Market, and thus the merchants who can arrange their acceptance in London gain thereby.

For exports generally the Indian exporter draws three months' sight D. A. or D. P. drafts. Such drafts are always purchased by exchange banks who get advice to this effect either from their head office or high financial houses with which the foreign importer of the Indian produce has opened credits. Exchange banks send such bills to London which when accepted by the London Banks or finance houses are easily discounted in the open market. Thus the exchange banks receive back in sterling the equivalent of their rupee payments in India. The drafts may sometime be sent to exchange banks for collection by exporters. In this case the exporters have to wait for money till bills attain maturity. The exchange banks even when they have purchased the bills, may also hold them till maturity under conditions of dull trade.

The bulk of our foreign exchange finance is done through bills in sterling. Formerly, before the World War II, drafts from and to Japan were in Yen. Bills connected with China are drawn in rupees. Usually, however, India does not maintain direct rate connections with other foreign centres for which a demand is incessantly made.

In the machanism of finance discussed above, two things are specially notewothy. Firstly, the bulk of our trade both imports and exports is financed by means of sterling bills and, secondly, in the finance of import trade, D. P. and not D. A. bills are commonly used.

These things have rightly been found unsatisfactory. Surely if our import trade is financed by D. P. bills, much benefit can be had by rupee bills. For the export trade the Indian exporter no doubt gets an advantage by means of sterling bills becaase drawing bills in London so long as credit can be opened obviously gives him an access to the London Money Market. But in the case of

import trade this does not happen. A very small part of the bills gets an advantage of the London market as they are not D. A. but D. P. *Thus the Indian importer has to pay the interest at the rate of 6 per cent which might still go up in case the Bank of England Rate exceeds 5 p. c. on all such 60 days sight D. P. Drafts.* Thus it is clear that the rate paid by the Indian importer does not depend upon the open London market rate of discount. In fact, import bills hardly play much part in the London Discount Market, and thus the process was never so cheap as was supposed. Therefore, rupee bills will be to India's advantage. But Exchange Banks' representatives have remained always opposed to the Rupee import bills. Sometimes they laboured hard to give weight to their arguments by suggesting D. A. bills in place of D. P. bills. But even then it is desirable to have the rupee bills, for they will help the developm nt of our bill market. The contention of the exchange banks that these bills are in small amounts and are of no use for a discount market cannot be accepted. Mr. Sircar rightly points out: 'If the exchange banks can lend as much as 30 crores to Indians on their local advances against import bills, inspite of the bills being in small amounts, surely a discount market could do the same and if it wanted to borrow on them, it might rediscount them in parcels to make up sufficiently large amounts. It is not. therefore, the size of the bills which has stood in the way of the creation of a discount market in India, but reluctance of the banks to part with the profits of the business.

Thus it is clear that the Indian Money Market suffers from the lack of an internal bill and and rediscount market mostly due to the existence of the immigrant banks. And this has been one of the greatest defects of the Indian credit organisation.

But this is not all. In their business operations as well, these immigrant banks have managed to function on most unsatisfactory and discriminatory system. They have definitely not been much use to Indian trade and business. It would be interesting to note the grievances of the Indian traders against these banks as have been voiced through their representative organisations from time to time:—

(1) The Indian importers, as pointed out before, are compelled to do business only on D. P. terms.

(2) In order to get a confirmed letter of credit opened, even first class Indian importing firms have to make a deposit

of 10 to 15 p. c. of the value of goods with the exchange banks, while European houses in Calcutta are not required to make such deposits.

(3) Satisfactory bank references are not supplied by the exchange banks to overseas merchants, though in the case of foreign merchants with considerably lower resources, the banks of foreign countries supply very good references.

(4) The Indian merchants have no opportunity of knowing under what rules the members of the Exchange Banks' Association work and they are not consulted with regard to alterations made therein from time to time.

(5) The exchange banks charge a penalty for the late completion of exchange contracts. The penalty is high and is capable of reduction.

(6) When a foreign exporter draws a bill on an Indian importer and the draft is with an exchange bank for collection, the Indian importer has to pay in rupees at the bank's selling rate for demand drafts and he is not allowed to pay it either by the demand drafts of another exchange bank which may be had at more favourable rates or by his own cheque on his London agent.

(7) The exchange banks discriminate between Indian and foreign insurance companies and they are forcing Indian exporters to insure their goods with foreign insurance companies. As a result of this attitude of the banks India has been paying annually insurance premiums to the extent of nearly Rs. 2 to 3 crores to foreigners.

(8) When a draft comes to an Indian importer through an exchange bank, the former merely gets an informal note asking him to go to the bank and examine the documents although in the case of some European firms the facility of sending the documents to their offices is allowed. The reason given by the exchange banks is that the party is not available. But it may be true only in the case of some small merchants. It cannot be thought in the case of big Indian merchants for example those in Clive Street, Calcutta or the Fort, Bombay.

(9) Although the exchange banks enormously profit by our foreign trade yet they do not employ Indians and do not make any provision for their training. Not a single Indian has been appointed in the superior grade of their service. It can hardly be accepted that these banks could not find a single Indian competent to hold a superior post in their business.[3]

Indeed, of the enormous profits that these banks make, a substantial portion is due to a policy of racial discrimination between Indian and non-Indian firms.

Below are given two tables which reveal the position of the foreign exchange banks as regards their deposits and the advances which they make in India.

TABLE A

From a Consolidated Balance Sheet of Foreign Banks

(Pre-war analysis)

			Rs.
1.	Total deposits (Indian and non-Indian)	...	66 crores
	(a) Indian Deposits—Rs. 39 crores		
	(b) Non-Indian deposits—Rs. 27 crores		
2.	Deposits with British Banks ...	...	57 crores
3.	Deposits with non-British Banks	...	9 crores
4.	British Banks' Advances in India	...	37 crores
5.	Non-British Banks' Advances in India	...	9 crores

TABLE B

Increase in Deposits of Different Classes of Banks

	1938	1941	1944-45
Imperial Bank	8151	10892	22459
Exchange Banks	6720	10672	14019
Other Schedule Banks	9187	12904	39965
Non-schedule Banks	1494	2005	4342

[3] Vide Findings of I. C. B. Report (Majorty), Pp. 322-327

Of this increase in deposits the percentages upto 1941 are worked out as given below:

Exchange Banks	...	59 %
Imperial Bank	...	34 %
Other Scheduled Banks		40 %
Non-scheduled Banks		34 %

The co-operative banks recorded an increase only to the extent of 8 to 9 percent.

Now the conclusions from these tables are obvious. Clearly the foreign exchange banks have established a 'foreign money trust' and 'an insidious system of economic penetration' into the interior of the country. These banks have been doubly fortunate. They have inflicted severe blows on our economic and banking structure with our own resources. This is the tale that is amply told by the tables given above. Even the Indian deposits of these banks (as shown in table A) are not advanced in India or utilised for purchasing India's securities. Table B shows their great penetration and influence. The percentage increase of their deposits during the first four years of the war left behind all other classes of banks. And this is a situation for great caution for future, for huge amounts were drained away which should have necessarily fallen to the lot of our banks. Is it, therefore, not a sad thing for us to observe that these immigrant banks should enjoy their prosperity mainly through our resources? Surely, the Indian banking structure is being robbed of its legitimate strength by the presence of these monopolitic insistitutions of foreign origin.

What is the way out? This question has been often considered. The lines of discussion had centred round two points:

(a) That an Indian Exchange Bank is needed; and

(b) That some resrictions be imposed on the working of the foreign banks.

It is undoubtedly true that we require a powerful Indian exchange Bank. But the suggestions, schemes and discussions in this respect have only been our pious hopes so far. In the past foreign exchange Banks have stoutly opposed such a move. Not long ago, a resolution was passed by the Bombay and Calcutta Exchange Banks'

Associations that 'no member should part with any portion of the commission and that there should be no rebates or repayments to the Indian banks and the agreements should be terminated.' The Indian banks, as observed earlier, do not have direct agency arrangements with New York. Therefore, those Indian banks that were authorised to deal in exchange business had gone through commission arrangements with the exchange banks. The above-quoted resolution was a sequence of these arrangements and it clearly recorded a strong disapproval of any such agreements from the exchange banks' representative bodies. Furthermore, it also gives us the hint that the foreign banks mean to continue their monopoly in future. In fact their whole history is a pursuance of this mischievous policy.

Nearly fifteen years ago these foreign exchange banks and the foreign experts attached to the Banking Inquiry Committee came out with a similar opinion in the following words: The present facilities of exchange finance are adequate. Since it is unsound, unthinkable and inconceivable to apprehend the withdrawal of the Exchange Banks, they (foreign experts) do not see much use from the establishment of an Indian Exchange Bank much less with any kind of state support and patronage[4].

Too long have foreign exchange banks opposed the creation of an Indian Exchange Bank and have done so with success. But now that we are a free nation and mean to build up our economic mechanism along sound and enduring lines, such opposition cannot stand in our way. Sooner or later, an Indian Exchange Bank—or perhaps several of them—must be established with active support of the Government; and the earlier, the better.

Suggestions to impose restrictions on the working of the foreign banks have been made several times in the past. At present, however, they seem to us to be wholly inopportune. The disease is chronic and deep. Mere restrictions will not do now. For our full prosperity and development, we will have to rid our banking organisation from such evil institutions. All banking facilities must primarily rest in our hands; and to achieve this objective in this sphere of banking we will have to plan forthwith with a strong hand and adopt stringent measures. We are wholly in favour of total liquidation of all immigrant banks. India, as we

[4] See Annexure to I.C.B. Majority Report, p. 571

know, has huge sterling balances exceeding a thousand crores of rupees to her credit. An effort should be made to utilise these balances for taking over the assets of foreign banks according to a well-planned scheme. The assets so acquired should be nationalised and a State-patronised Indian Exchange bank should be started. The details of this bank may be worked out by a committee of experts. Since most of the foreign exchange banks are British-owned, the process of purchasing over the assets will not be circuitous and complicated. The national government which we have now installed is definitely out to root out all vested interests. It will be in accordance with their policy to fully strike at the root of foreign exchange banks with are doing incalculable harm to our economy.

The suggestions which I would like to make are, therefore, given below:

(1) Complete liquidation of all foreign banks. A plan should be chalked out. The liquidation need not be sudden; it may be spread over a period of five years.

(2) Immediate setting up of a State-patronised Indian Exchange Bank. The other Indian banks should be permitted to do this business only under a licence to be granted after the fulfilment of certain conditions, and they must work in close cooperation with the Indian Exchange Bank.

(3) Any encroachments on this business from foreign countries should be banned under law for at least a period of fifteen years. After that the law may be relaxed and the foreign banks might be permitted to open their offices under restrictions similar to those as are generally imposed in other countries.

VII

THE FINANCING OF FOREIGN TRADE OF INDIA

BY

B. N. Chatterji

The financing of foreign trade differs in many respects from the financing of domestic Trade. In export and import trade, the risk is far greater for the buyer and seller due to the fact that the parties are often separated by long distances and have to operate under divergent laws and customs which tend to make settlement of disputes and legal redress in the court on default by one or the other party often difficult and costly. Moreover, there is always the risk of fluctuations in the rate of exchange between the exporter's national currency and that of the importer. In recent years, the difficulties of the foreign trade dealers have been accentuated still further by quantitative and global quotas, restrictions on foreign exchange dealings, *viz.* centralisation of foreign exchange dealings, blocking of currency. etc.

Some of the risks referred to above are almost unavoideable. The exporter, however, tries to minimise the risks as far as possible by insisting on terms and conditions which afford a reasonable measure of protection to him. For these reasons, terms of sale in foreign trade differ much from those prevailing in domestic trade, and specific security tends to take the place of unsecured credit.

Financing Methods in Foreign Trade

The methods of financing may be classified as follows:

(1) Financing by the importer

  (a) Payment with order

  (b) Payment against documents or against merchandise

(2) Finance by the exporter

  (a) Open credit

  (b) Exporting on consignment account

  (c) Trade bill (for collection)

(3) Financing by the exporter's or importer's bank

(a) Acceptance credit

(b) Documentary credit

(c) Authority to purchase

The importer may carry the entire burden of financing. In some cases partial or complete remittance must accompany his order. Since 1931, American exporters have often insisted on partial payment in advance from foreign importers. This system of each payment is customary in cases necessitating a large investment of capital on the part of the producer or manufacturer of goods to special specifications which cannot be disposed of readily if refused by the buyer. Again, the importer may be required to pay cash against documents. Usually the importer in such cases deposits the sum with a bank in the exporter's country, which pays the exporter against surrender of documents.

The exporter, on the other hand, may undertake the entire burden of financing. He may grant Open Credit to the foreign buyer, which consists in debting the buyer in his books without any material guarantee. The invoice value is entered in the books as due on a certain day. In this connection, a distinction has to be made between single invoice items figuring as Open Ledger debts or forming part of an Account Current with calculation of interest. In the first case, the business connection between the parties is limited to single transactions, each individual invoice amount being figured as due on a certain day. In the case of Account Current relations, however, each individual item loses its independence and marges in the Account. If an Open Credit Account is used, the exporter must rely entirely on the honesty and integrity of the importer so that such accounts are generally opened only in favour of old and reliable customers in foreign markets. This method was often used by German exporters.

The exporter may also export goods to his agents abroad on Consignment Account. Here too, the exporter has to assume the entire burden of financing his shipments. Normally banks do not finance shipments on consignment or open credit accounts.

From the exporter's point of view a far more satisfactory method is to draw trade bills on the foreign importer. The documents attached to the bill, *viz.* invoice, bill of lading, certificate of

insurance, and consular certificate, may be released either against payment (D/P) or against acceptance (D/A). In both cases the exporter hands over the bill together with the documents to his bank for collection and the bank forwards them with the exporter's instructions to its correspondent bank in the importer's country. If the bill is drawn under D/A terms, the documents are handed to the foreign importer on acceptance while in the case of D/P bills the documents are not surrendered until payment is made by the importer. After payment the bank remits the funds to the exporter's bank which in turn credits the exporter's account with the amount of the bill less collection and stamp charges.

The use of trade bills sometimes makes it necessary for the exporter to arrange the financing of the transaction. If he is not in immediate need of funds, he simply turns over the bill for collection to his bank. If, on the other hand, he is unable to finance the transaction himself, he may borrow from his bank on the security of the bill or he may, if his credit standing is high, discount the bill with his bank which will then supply him with funds. The bank may also arrange a "refinancing acceptance" in respect of D/P bills. The exporter offers the bill together with the documents as security to the banker and as against the bills he is allowed to draw a clean bill on the bank which the latter accepts, After acceptance the bill is discounted in the market at a lower rate than the usual market rate. On maturity the acceptance is retired with the proceeds of the trade bill which the accepting bank will have collected in the meantime.

The financing of foreign trade may also be effected either by the importer's bank or exporter's bank Generally it is the importer's bank which will be called upon to assume the risk of financ ng. The credit which is usually granted for such purposes may be either Acceptance Credit or Documentary Credit.

When an Acceptance Credit is opened in favour of the exporter, the latter is authorised to draw a draft on the bank issuing the credit up to the maximum limit allowed. The draft is D/A and must be accompanied by the usual documents. On acceptance by the bank, the draft is returned to the exporter, the documents, however, being retained by the bank. The acceptance is then discounted in the market. In the meantime, the importer provides the accepting

bank with funds with which to meet the acceptance on the due date.

From the point of view of the exporter, acceptance credit is satisfactory but it is not always possible for the importer to arrange this form of credit with his bank. Banks are generally more inclined to grant Documentary Credit. According to the terms of such credit, the bank issuing the credit undertakes either to discount the draft drawn by the exporter or to make an advance on the security of such draft. The draft is drawn on the importer either under D. A. or D. P. terms. In any case, the bank collects the draft and where an advance has been made to the exporter there is an adjustment of account after collection and the balance of the proceeds is handed to the exporter.

Another method of financing foreign trade employed by American importers particularly in dealings with Far Eastern countries is known as "authority to purchase". The importer contracts to purchase goods from the foreign exporters and authorises the latter to draw bills on him. He gives his bank a letter of guarantee, undertaking to accept the bills drawn upon him and honour them at maturity. The bank thereupon instructs its foreign branch or correspondent to buy the exporter's bills. This advice to the foreign institution is known as the "authority to purchase".

Sometimes the exporter finds it necessary to finance his shipments through his bank. There are many big London Export Houses which regularly export goods to their branches and agencies in overseas countries. They do not want to draw bills on their own branches for the obvious reason that these bills cannot be negotiated in the London Discount Market. They accordingly arrange acceptance credit with London Banks whereby the drafts are drawn on these banks. After acceptance, the drafts are discounted in the market. The accepting banks realise the amount due on the bills from the Export Houses, overseas branches and agencies.

Financing of Foreign Trade of India

Import Trade Finance. The bulk of the import trade of India is financed b :

(a) 60 days sight D. P. drafts on the Indian importer. About 9/10ths of the import trade is financed by means of drafts for which no credit arragements are either demanded or

made with banks. These drafts are handed by the foreign exporters to their own banks for collection and are subsequently forwarded to the collecting banks' branches in India. The drafts are presented to the drawees for acceptance and thereafter they are held until maturity or retirement before time.

(b) London Banks' acceptance of "house paper". There are many big London Export Houses which export goods to their branches and offices in India. They usually draw the bills on the London offices of the exchange banks or London Joint-Stock banks which aceept these drafts and reurn them to drawers who in turn discount them in the London Money Market. The accepting banks forward the documents to their branches in India for collection of the proceeds from the branches of the export houses in this country. A remittance is later sent to London before the maturity of the acceptance.

A limited amount of trade is also carried on through the medium of Documentary Credit which amounts to an authorisation by the importer to his banker to make advances to the exporter or in some cases to negotiate the drafts on presentation.

A very small amount of business is also done under banker's confirmed credit under which drafts are to be drawn by the foreign exporter on the importer's bank. Usually this credit is not available to Indian importers. Big Indian import houses which have London offices do sometimes get the benefit of acceptance credit of the London banks.

Import bills are generally drawn in sterling at 60 days sight. There is also a fair proportion of 3 m/st paper but not many 6 months sight bills are drawn.

Wherever bankers buy or advance against such bills, it is customary for the drawers to include an interest clause under which the bill bears interest at an agreed rate from the date of the drawing of the draft upto the approximate date of arrival of the proceeds of the bills in London.

Interest bills are in sterling but they are paid in India in Rupees and the rate of exchange may be either the rate for T. T. or D. D. on London for that day; while others state "Payable at the X Bank's

drawing rate for D. D. on London". If the bill is paid before maturity interest is adjusted accordingly. It occasionally happens that the drawer himself arranges to pay interest, in which case the London Branch of the bank will claim the interest from him in due course on hearing from the Indian branch the actual period for which the advance was carried.

Shipping documents attached to the bill may be surrendered either on acceptance or payment according to the instructions given by the drawers. Bills on Indian importers are generally drawn on D. P. terms while those drawn under London Acceptance Credit are on D. A. terms. In the case of D. P. bills the relative documents are retained by the collecting banks until the drafts are retired on payment by the importers. In such cases, the banks clear and store the goods and take all necessary steps for the protection of the drawer's interest until such time as the acceptors are ready to taks up the bills. It may be easily realised that the importer is greatly handicapped when the bill is drawn under D. P. term. He cannot get possession of the goods until he retires the bill on full payment. It is true that he is given facilities by the bank for selling the goods but as partial delivery against partial payment is not usually allowed, he often finds it difficult, if not altogether impossible, to sell the entire consignment. In recent years, the exchange banks have shown an increasing tendency to accomodate the Indian importer by releasing the documents in exchange for trust receipts under the terms of which the importer undertakes to make proper arrangements for the storage of goods and hold the proceeds of the sale thereof in trust for the banker. After the goods are sold, the importer has to hand over the entire proceeds to the banker who after deducting the amount due to him, refunds the balance to the importer. The banker of course charges interest on the trust receipt which is taken as a kind of loan transaction. Indian witnesses, whe gave evidence before the Central Banking Enquiry Committee, brought a number of complaints of importers to the notice of the Committee, one of which was that the exchange banks were mainly responsible for the drawing of the import bills under D. P. terms, since they often gave unsatisfactory bank references regarding the financial standing and credit risk of Indian importers. It was pointed out that the exchange banks discouraged D. A. facilities with a view to encourage loan business on trust receipts in order to earn a higher rate of interest. The representatives of the exchange banks, however,

repudiated this suggestion and pointed out that the question of drawing bills under D. A or D. P. terms was entirely a matter of agreement between the foreign exporters and Indian importers. Whatever might have been the reasons for this practice in the past, there does not exist any justification for its continuance in future. In recent years, many Indian houses have come to take a prominent part in the import trade of the country and in point of magnitude of operations and financial resources, they can easily hold their own against big European mercantile houses

It has been pointed out elsewhere that most of the Indian import bills are in sterling. Before the World War II, a few rupee bills were drawn by German and Japanese export firms but the amount of such bills was not large. This practice stands in the way of the development of a bill market in India. So long as import bills are drawn in sterling, it is obvious that such bills cannot be discounted or rediscounted in India. It is, therefore, clear that if a bill market is to be created in this country, it is essential that the import bills should be drawn in rupees. Something could be said in favour of the existing practice if the import trade of India was financed in the cheapest way with the help of the London Money Market but in reality the Indian importers have to pay interest at a rate which is much higher than the open market rate of discount in London. Formerly the rate was 6 p. c. It has now been reduced somewhat but even then it is much higher than the open market rate in London. The creation of a bill market in this country will take time and in the meantime the exchange banks, as the Central Banking Committee pointed out, should cosider the possibility of changing their present custom by accepting the bills instead of purchasing them, in the same way as London house paper is accepted by them, and the bills could then be discounted in the London market. It may be pointed out here that it is the recognised practice in international commerce to draw bills on foreign importers in the currency of the importer's country unless such currency is depreciated or unstable. There is no reason why the Indian importer should continue to take the risk of exchange fluctuations in future. When an exchage bank holds for collection a draft drawn by a foreign exporter on an Indian importer, the latter is required to pay the bank in rupees at the bank's selling rate for demand drafts on that day and he is not allowed to pay it by the demand drafts of another exchange bank which may be had at cheaper rates except on payment of a commission of ½ p. c. or by his own cheque on his London balances. The

exchange banks, however, accept T. Ts. of such banks which are members of the Exchange Bank's Association.

The movement of imported goods from the ports to the inland distributing centres is generally financed by commission agents, shroffs, Indian joint-stock banks and exchange banks. At inland distributing centres like Delhi, Cawnpore and Amritsar, the import bills are generally D. P. and are paid on or before the due date by the importers who very often retire the bills by means of loans granted to them by joint-stock and exchange banks against a margin of 20 to 25 p. c. of the value of the goods. The importers sell the goods either for cash or on 2 to 4 months' credit to wholesale dealers with interest at 6 p. c. per annum. The wholesale dealers in turn sell the goods either for cash or on credit to retail dealers in the villages. In the latter transactions the commission agents play an important part.

The import of bullion both gold and silver used to be financed by exchange banks by payment in London or New York against shipping documents. The bullion dealer on whose account the bullion was purchased was required to enter into a contract for the purchase of bullion T. T. On aarrival of the bullion in Bombay, the bank would make arrangements for clearing the consignment and storing it in its strong room. The dealer was required to take delivery within 7 days on payment of the price plus interest from the date of purchase of bullion up to the date of payment in Bombay. During the war, the import of gold and silver on private account was prohibited and the ban on such imports still continues.

Apart from gold and silver, the imports of several other commodities like drugs and medicines used to be financed by cash payment in London or New York against shipping documents. The payment used to be made through exchange banks.

Mechanism of Finance of Indian Export Trade

Indian export bills are drawn usually at 3 m/st and are chiefly documentary though clean bills are not altogether uncommon.

The credits are not always opend by the exchange banks. Frequently it is the London banks and Finance Houses which open these credits and advise them out to India through exchange banks. The documentary credits opened by the exchange banks in India are those sent out by the banks' London offices at the request of the London importer and in such cases it is the British importers who accept the bills. Where the credit is opened at the instance of the London

banks, drafts are sometimes drawn upon and accepted by the banks issuing the credit. The bills may be D. A. or D. P. ,the general practice being to draw D. A. bills. Bills drawn on banks under acceptance credit are invariably drawn under D. A. terms.

Drafts drawn under acceptance credits are discounted by exchange banks but those drawn under documentary credits are not always discounted. As the exchange banks have the option of either discounting such drafts or making advances against them, they very often prefer to make advances to the exporters up to 60 or 70 p. c. of the amount of the bills. In some cases the advance is made only after the drafts are accepted by the foreign importer. As has been already pointed out, the export bills are usually drawn in sterling and accordingly they are collected in London. Such D. A. bills as are discounted by the exchange banks in India are generally rediscounted in the London Money Morket after acceptance but the D. P. bills are held in London until maturity or until retirement before due date. Under the rules of the London Discount Market, the D. P. bills are not eligible for rediscount since such bills are generally retired before maturity with the consequence that the investment policy of the discounting banks is very often upset. By rediscounting the D. A. bills, the exchange banks manage to have a regular flow of funds in London which is available for financing the export trade of England with this country. During the World War I, when the rupee-sterling exchanges were unstable, the Indian exporters and importers tried to insure themselves against exchange risk by entering into forward exchange contracts with the exchange banks but after some time the banks stopped all dealings in forward exchange in view of the losses suffered by them.

The exporter needs finance not merely at the time of the shipment of goods but also at the time of the purchase of such goods from the market. At present the finance obtained by the merchant is by means of a cash credit at a high average rate of interest with an added condition in some cases that interest will be charged on half the maximum amount of the loan whether fully availed or not. It has been suggested that it would be an advantage to the exporter if in place of the cash credit system, the system of acceptance credit were introduced under which an exporter could arrange with a bank in India for acceptance credit in his favour. This would enable the exporter to draw on the bank for the amount of the acceptance and would make it possible for him during the life of these drafts to send

the goods forward, draw an export draft on his customer and offer it for sale to the banker in liquidation of the rupee acceptance. There are, however, some difficulties such as the practical non-existence of documents of title *viz.* warehouse warrants and railway receipts in suitable form and high stamp duty on bills, which stand in the way of a wider use of acceptance credit for financing the inland tradè of this country. But these difficulties can certainly be overcome and now that the war is over the Reserve Bank of India should take early steps for the introduction of acceptance credit on the lines of the dollar acceptance credit in U. S. A. which has proved so helpful in the expansion of the export trade of U. S. A.

As regards export trade the movement of produce from the village to the *mandi* is largely financed by money-lenders, indigenous bankers and to some extent by cooperative agencies, Imperial bank, and joint-stock banks. The exchange banks do not finance the movement of produce at this stage but when the produce is moved from the mandi to the exporting centres the exchange banks along with the Imperial Bank and joint-stock banks take a direct part in financing. The purchases by exporting firms at the *mandis* are financed by *shroffs* who make payments to the producers. The *shroffs* reimburse themselves by drawing demand Hundis on the export firms and selling them to the Imperial Bank and joint-stock banks with their own endorsements.

Financing of Indian Foreign Trade during the Last War

During the World War II, owing to export and import trade control, there was very little foreign trade on private account. The exchange banks could not, therefore, take a large part in the financing of our foreign trade. With the extension of the war to North Africa, Central Russia and Caucasus, there sprang up a large demand for Indian raw material, food stuffs and manufactured products. These were purchased by the Suyply Department of the Government of India directly from the producers or market and exported by government or U. K. C. C to Iran, Iraq, Egypt, East Africa, England and U. S. A. The Supply Department gave the sellers liberal financial facilities which in some cases were supplemented by advances made by banks. These transactions did not give rise to bills of exchange and as such throughout the period of the War, dealings in foreign exchange were comparatively few.

As regards import trade, goods were largely imported on government account from U. S. A. and the Empire countries mainly for

meeting war requirements. A vast amount of war material, motor trucks, provisions, and stores etc. was imported from U. S. A. under Lend-Lease arrangements. For these imports, no payment was demanded or made. A small quantity of consumer goods also was imported from U. S. A. These were paid for by the Government of India out of the dollar allotment to India from the Empire Dollar Pool. The imports from the Empire countries were directly financed by the Government of India partly out of the proceeds of our exports to those countries and partly out of the sterling balances placed at the disposal of the Government of India by the British Government. Thus here too the exchange banks did not have a large part in the financing of our import trade during the War.

From a study of Indian foreign trade finance it is clear that the exchange banks have an exclusive monopoly in this business. Apart from the fact that these banks which are non-Indian in domicile and management have shown little sympathy with the interests and aspirations of India's businese men, they earn an enormous amount of profit from this business which is remitted to their head offices from time to time for the distribution of dividends. Exact figures of these profits are of course not available but the amount involved must be considerable The remittance of these profits constitutes an economic drain from this country which at a time when every country is alive to its economic and political interests, must not be allowed to continue. It has also been observed by competent authorities that the very small percentage of Indian's share in the foreign trade of India is a consequence of the financing of their trade being the monopoly of non-Indian exchange banks. It is only natural that foreign banks should try to further the interests of the nationals of their countries. Indians must not in their own interest rely for all time on the credit facilities provided by these non-Indian Banks.

Indian joint-stock banks do not like to take part in foreign trade finance which requires a highly specialised knowledge of foreign exchange business. Years ago, the Tata Industrial Bank did some pioneer work in this field, but its experience was so unhappy that it had to give up this business owing to heavy losses. The next attempt was made by the late Sir Sorabji Pochkhanawala, the then Managing Director of the Central Bank of India, who started an Exchange Bank with an office in London. This bank too did not meet with much success and was subsequently taken over by the P. & O. Banking Corporation. Under the Imperial Bank Amendment Act of 1934, the

Imperial Bank has been permitted to deal in foreign exchange but according to the latest information available it appears that bank has not yet taken up this business on a large scale. The only Indian bank which is doing exchange business on a fairly large scale is the United Commercial Bank.

The Central Banking Enquiry Committee made a recommendation for the establishment of an All-India Exchange Bank with State assistance. So far no action has been taken by the Government of India. It may be pointed out here that it would be comparatively easy to start a State-aided and State-controlled Exchange Bank. To work it successfully, however, would be an altogether different proposition. The success of exchange banking depends to a large extent on a judicious distribution of funds in India and foreign centres. A State-assisted Exchange Bank would, by collecting import bills, be in a position to command fairly large funds in this country. But to transfer these funds to foreign centres would, in the absence of support and cooperation of foreign import houses, undoubtedly present considerable difficulties. In view of the conditions brought about by the last world war, it would be futile to expect such support from foreign import houses. But these difficulties can be overcome. In U. S. A. the liquidation of the Edge Law Banks which were formed for the expansion of American export trade did not discourage the authorities. The administration of the late President Roosevelt embarked on a bolder experiment by the creation of the Export and Import Bank of Washington. The activities of the Export and Import Bank during the last war and the success which attended its efforts for furtherance of the export trade of the U. S. A are too well-known to need mention. What the American Government have been able to achieve in this field, should not be beyond the competence of the Government of Free India.

Even if an Indian Exchange Bank is started in the near future, the problems of the exporters and importers will not be altogether solved. There are many importers of humble financial resources who will not be able to get accommodation from the exchange banks. The credit requirements of these importers will need special consideration. Further, many industrial concerns will have to incur heavy capital expenditure in connection with the import of machinery, equipment etc. It is not likely that all of them will be able to raise the necessary funds within a short period of 2 or 3 months which is the usual currency of the bills. It is clear, therefore, that unless these industrial

concerns get longer credit than is usually allowed they will not be able to modernise their equipment. Further there exist no facilities for instalment finance in this country. Even the Indian Exchange Bank, if started, will not be able to undertake such heavy commitments singlehanded. It is, therefore, worth consideration if an Export and Import Credit Scheme on the lines of the Export Credit Scheme in force in Great Britain should be introduced in this country. There is also another problem which will acquire importance in future. In future, India is sure to have increasingly larger trade with the U. S. S. R. and Sovietised Poland. These are State-trading countries. Trade carried on with them through the ordinary trade agencies can never be satisfactory. A special State agency on the lines of the U. K. C. C. may have to be set up in this country for carrying on and financing trade with State-trading countries.

VIII
THE DEVELOPMENT OF MARKETING FINANCE IN INDIA

BY

D. S. Sastri

Industrialisation of India on a planned basis is being carefully considered in all its various aspects, and in free India the pace of industrialisation is bound to be accelerated. The question of starting an institution specialising in industrial finance to help the development of industries has been engaging the attention of the Government. The development of marketing finance, however, does not appear to be under consideration side by side, though this aspect of finance is equally important. The marketing of agricultural produce which is exprted to other countries and the distribution of manufactured goods imported into India are in the hands mainly of foreign firms. As internal marketing of indigenous manufactures and produce is carried on in age-long and time-worn methods, the financing of such operations is being done on uneconomic and unscientific lines. It is however desirable and necessary that alongside the development the industrial finance there should be a simultaneous development of of marketing finance too so that agricultural produce as well as goods manufactured in the country can be disposed of in the best and most economical manner on an uptodate and scientific basis. For this purpose an active bill market will be of great help and even indispensable and has therefore to be brought into existence at the earliest opportunity.

The development of a bill market is an essential feature of any scheme of improvement of a country's monetary system. As there is at present no practice of selling mercantile transactions by the use of bills of exchange it will take several years of preparatory work to educate the financial and business community so as to bring into existence a real and highly developed bill market. Considerable improvement of the credit structure in India can be achieved by improving and extending as far and as soon as possible the use of trade bills in all mercantile transactions and thereby stimulating the use of *muddati hundis*. No organised attempt has so far been

made to popularise the use of *hundis* and develop an effective bill market in the country. The prevailing practice amongst industrial concerns and wholesalers is to sell manufactured goods on credit or on consigment basis and adjust the accounts perioidcally. Huge book debts are thereby created locking up working funds and retarding the growth of industry and trade. As book debts are not usually accepted as security by banks, the working finance of such manufacturing concerns and traders gets locked up, thereby increasing the requirements of running finance; and this acts as a serious handicap to industry in a competitive market. If there were in existence financial institutions specialising in the discount of *hundis* the buyers of goods can execute *hundis* in favour of the sellers at the time of taking delivery of the goods and the sellers could easily obtain cash by discounting such *hundis* in the bill market. The buyers under this arrangement get the required time to dispose off the goods and pay the *hundis* on due date. This will relieve the manufacturer and the trader of the necessity of procuring moneys up to the extent they get locked up in book debts and will enable them to utilise their financial resources to maximum advantage. With the development of the use of commercial bills and ultimate creation of an active bill market, a large portion of finance lying stagnant in the shape of book debts in the country will thus be freed and brought into circulation and one of the missing links in the credit structure of the country will thus be provided.

Alongside the planning of industrial development, attempts are being made to develop the marketing of agricultural produce by increasing transport facilities on a planned basis. At the time of the starting of the Reserve Bank, special provisions were made for financing the conserving and the distribution of agricultural produce, but so far banks have not been able to obtain rediscounting facilities from the Reserve Bank for want of documents of title to goods evidencing the proper storage of produce. It will be a fairly long time before a Warehousing Act is passed and warehouses actually come into existence. There is however no reason why agricultural paper eligible for rediscounting facilities could not be created by indigenous bankers and by small joint stock banks by obtaining *muddati hundis* with a usance of 6 to 9 months instead of the demand promissory notes that are now being obtained. If only the methods of business of these money-lending institutions are sound, such as would inspire utmost confidence, financial institutions

specialising in *hundi* business could discount such bills. Agricultural paper of this nature could thereby be brought into existence and it is possible that the Reserve Bank could ultimately be induced to rediscount such paper. A large volume of finance is now being furnished by money-lenders and indigenous bankers and if instead of its getting stagnated, it is canalised, the conserving of produce could be made cheaper and more efficient. This is, however, an uphill task but if concerted attempts are made to organise and develop this aspect of marketing finance a great step forward for organised marketing will have been taken.

The distribution of agricultural produce can likewise be financed on a scientific basis by popularising the use of *muddati hundis* during the period when crops are moved from the market to the factory for manufacture or to the seaports for fóreign export. Normall it takes about three to six months for agricultural produce to reach the ultimate consumer, after undergoing some industrial or semi-industrial process or other; and during this period, if market finance is properly developed *muddati hundis* with a usance of about one to three months could be brought into existence with first class negotiability and thus help the healthy growth and development of trade in the country. In the same manner, produce meant for foreign export requires about a month or two before it is actually shipped and during the interim period finance could be arranged by popularising the use of *muddati hundis*.

For any scientific working of the bill market, a clear distinction has however to exist between a trade bill and a finance bill. Such a distinction does not exist in India now for the reason that there is no organised marketing and as goods pass through several hands before they reach the ultimate consumer, no attempt is made to bring into existence genuine trade bills in the process. Marketing finance is consequently arranged on the personal credit of each dealer. Indigenous bankers are no doubt furnishing the required marketing finance by discounting *muddati hundis* to a limited extent but so long as they do not publish their audited balance sheets and do not take appropriate steps to standardise and improve their business methods, it is unlikely that they will be able to create bills available for discount. The *hundis* that are at present discounted by Indian joint stock banks are accepted solely on the standing and position of the signatories to the bills without any enquiry as to whether they represent genuine trade. The banks do not have the

time or the inclination to devote attention to the development of a bill market in the country as, for them, discounting of bills is only one of ever so many other activities.

Multani *shroffs* deal in hundis drawn in their favour by borrowers with a promise to pay after a definite period of 60 to 90 days. These *hundis* represent mere moneylending transactions. The *shroffs*, however, lend only to businessmen and take care to see that the bills are promptly paid on maturity. A special technique has been developed by these Multanis for over half a century. Their bills are discounted by the bigger joint stock banks at bank rate. These *hundis* could be classed as financial bills in a broad sense of the term as against genuine trade bills. The difficulty, however, is that the banks which discount the *hundis* have very little knowledge of the position and worth of the drawers and have no direct touch with them. The Multani *shroffs* are practically of the same category as the indigenous bankers as they do not reveal their exact financial position. Banks are, therefore, generally guided more by their ability and standing than by their worth. If, however, an institution specialising in discounting of bills were to organise an efficient credit investigating agency, it should be possible to effect a great improvement in the present unsatisfactory conditions and obtain for these *hundis* a status analogous to that of finance bills eligible for rediscount by the Reserve Bank of India.

This is an opportune time for the development of a bill market in the country as the Government are actively encouraging and helping the establishment of a number of industries. Several industries have already come into existence and many more are coming in at no distant date. These industries require large marketing finance and any institution which will relieve them of the burden of the locking up of valuable working capital in the form of Book Debts will find a ready and immediate support, particularly as the industries have not reached such a stage of affluence as to command large reserves which could be utilised for working capital.

It hardly needs mention that in a business of the type above described, institutions specialising in this type of finance run very little risk of incurring Bad Debts. In the first place the bills represent genuine trade, the amount of each individual bill would be small, the risk widely spread, and finally the period of maturity

being always of a fairly short duration not exceeding 90 to 120 days, there is no risk of wide fluctuations taking place either in the standing and respectability of the individual parties or in trade conditions. In addition, institutions of this type have no necessity to incur large overheads by way of spacious buildings, service charges and other establishment expenses usually associated with banking institutions. Institutions of this nature would be in a position to create pyramidial structure of credit thereby increasing not only the profit of the concerns but also their utility to the mercantile community. They would constitute a definite step in advance of and an improvement over the existing Multani *shroffs* or other similar institutions handling this type of bill business and they would ultimately work as handmaids to industry and commerce and facilitate the establishment of a real and scientific bill market.

Care must, however, be taken to see that there is no slavish imitation of similar institutions in other countries. The bill market in India has to develop on lines essentially suited to indigenous conditions as the analogy of the development of such institutions in other countries like the United Kingdom or the United States of America has only a limited application. For instance, the bill market in the United Kingdom is mainly in the hands of Discount Houses which have developed and have come into their present position of importance over a period of about a century and a half. This development is due mainly to the requirements of London as an International Money Market. The bill market in London is of a still longer duration and if at present it does not occupy the same important position in the financial world as before it is mainly because London is not now the same International Money Market it used to be before the World War II. In India, we have had so far no bill market worth mention and it is inconceivable that India will become an international money market in near future. Development must therefore be on independent lines in keeping with the country's peculiar conditions and if, in the process of development, institutions largely different from those in existence in the United Kingdom have to be brought into existence there should be no hesitation in doing so. In the present undeveloped state of the bill market, institutions specialising in marketing finance may have to undertake certain incidental banking work also so as to render a complete service for marketing finance. There are no

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Acceptance Houses in India nor are the Indian Joint Stock Banks accustomed to accept bills on behalf of customers and so, in the early stages, institutions specialising in marketing finance may have to enjoy a status similar to scheduled banks so as to infuse confidence not only in those who offer bills for discount but in those who rediscount the bills of such institutions. The matter requires careful consideration and it is time sufficient thought and attention is devoted to this aspect of the financial structure of the country.

IX

BANK FAILURES IN INDIA

BY

S. K. Muranjan

The failure of a bank is a matter of much wider concern and suffering than the failure of any other joint stock enterprise of comparable size. A joint stock enterprise involves in its failure a limited number of shareholders in the main. Unlike joint stock enterprises of other kinds, a bank is not only a profit-earning investment for its share-holders but acts also as a reservoir for the savings of numerous customers. In an advanced community, a general banking break-down tends to become co-extensive in its consequences with the bulk of the population. A general banking crisis as distinguished from a crisis in the fortunes of an individual bank has also a deep significance for the monetary system of a country. It is hardly necessary to stress the place of bank deposits in the monetary circulation of a modern community. Inability of banks to meet their demand obligations must bring to a stand-still all dealings between creditors and debtors, and therefore the whole economic system.

The causes which bring into difficulties an individual bank or banking system are not easily separable or definable in specific categories. The importance of each major cause is apt to vary from one country to another and from one phase of the banking system to another. To a country like India, a comapratıve or historical study of bank failures should be extremely useful as bringing out the strength or weaknesses of its banking system and furnishing some general guidance to the future.

Failures of Immaturity

Banking in every country has passed through a phase of immaturity during which it suffered inevitable disasters. The British banking system is quite properly judged as one of the strongest the world has seen during the last two hundred years. Yet, the road along which it has travelled to its present admired position is strewn with not a little wreckage. A phase of immaturity is to a certain extent unavoidable since banking-wise public and banking-wise executives

are slow to take root and grow. Till legislation or threat of legislation compelled banks to adopt better policies and practices about the middle of the last century, British banks showed all the usual weaknesses of immaturity. Inadequate capital, loans against share-capital. absence of publicity, unqualified managements, predominance of private and personal interests—these and other allied defects were not a little responsible for the disappearance of scores and hundreds of private banking houses from time to time. England had also to contend against another difficulty from which the banking systems which came later on the stage were happily free. The joint stock company form of banking was still evolving and was still far away from its present developed stage.

Since European enterprises of the 19th century are not to be reckoned as a part of the Indian banking system, the immature phase of Indian banking is properly placed in the first decade of the present century. The banking crisis of 1911-13 may be regarded as the penalty we paid for this immaturity. Yet, it is reasonable to ask the question whether this unfortunate experience was unavoidable. The bank failures of England adverted to above, which occurred chiefly before 1860, could be largely explained by the fact that England was a pioneer in this as in many other fields. The experience of England should have been available to India in avoiding the price which pioneering can hardly escape. Immaturity need not be an embarrassment unless the obvious legislative safeguards are absent. Unfortunately, the Government of India was averse to legislate in anticipation and even after the crisis, it took as many as twenty years and more to put on the statute book the most elementary legislation on the subject. Democracy is notoriously incapable of thinking ahead but the famed bureaucracy of India was not in any manner restricted by democratic compunctions.

Failures of Structural Weaknesses

Certain banking systems have developed certain structural peculiarities which on occasions prove no mean source of weakness and difficulties. The best example of this is the unit banking system of the United Sates of America. The causes which have led to this result need not detain us here. But there is no doubt that this feature of the American banking system is against all inherent tendencies of banking as such and runs counter to the dominant trends in all other fields of economic activities. In the recent banking crisis in that country, not even all the accretion of powers in the hands of the

Federal Reserve System proved of avail to cope with this fundamental weakness of commercial banks. Since vested interests created by unit banking do not permit of any drastic reform on this head, the remedy has to be sought in still further accretion of powers in the Federal Reserve System in the hope that the decentralisation of the American banking may be counteracted thereby.

Fortunately, freedom of branch-banking has created a strong tandency to concentration of banking resources in India. The Imperial Bank of India, the dozen and a half Exchange Banks and the seven or eight bigger Indian joint stock banks hold the greater part of the banking resources. The degree of concentration is not perhaps comparable with England or pre-war Germany. To the extent to which smaller banks running into a few hundreds still continue to exist, it might appear that an element of weakness is still present. There are however several important reasons why for many years to come, these banks cannot be dispensed with. The size of the country itself makes it difficult for the bigger banks to develop immediately that high degree of adaptability which can enable them to meet the special requirements of diverse localities. In the initial stages at least, local banks alone are well qualified to cultivate these areas; unit banks have perhaps a legitimate palce in countries of the vastness of India and the United States. Again, in no country in the world have joint stock banks found it feasible to meet the financial needs of certain classes of borrowers. Cottage industries, medium size farmers, professional classes, contractors, building traders, etc. may be cited as examples. Smaller banks might prove the salvation of such classes of producers.

One important stimulus to the growth of Indian banking in the present century has been the belief that industrialisation is likely to be speeded up if banks are started with industrial finance as an important part of their mission. In the earlier years in particular, banks with this objective were to be found in different parts of the country. But sizeable ventures of this kind were very few and their lack of success seems to have curbed the earlier enthusiasm. It appears that industrial banks or, to put it more accurately, mixed banking achieved a good deal of success in the last century in several countries but with the advent of the present century, the type has gradually fallen into the background. Mixed banking is perhaps an intermediate phase and when a country is sufficiently industrialised and habit of direct investment has taken firm root, there is a tendency

for banks to withdraw from these risks. In any case, mixed banking is not sufficiently important in this country to be regarded as a possible source of weakness to the banking system.

In more recent years, there is observable another tendency the implications of which cannot but be a matter of serious concern to all friends of Indian banking. It appears that each group of industries arrayed round some enterprising personality considers it necessary or specially advantageous to have at its disposal or command a bank dominated by the same influences. The causes of this development are not easy to state precisely. It is possible that the mere wartime restrictions on investment suggested banks as the only possible line for the promoter and the entrepreneur. It is also probable that the very paucity of oligarchic character of business enterprise in this as in other countries makes it inevitable that a few persons should directly or indirectly obtain sway over all the major industrial or financial concerns of the country. Perhaps the most probable cause is the desire to release themselves from the independent check of institutions which by the very law of their existence must sit in judgment on each application for credit. Even in ordinary circumstances, it is not easy to exclude the influences of trade and industry from the management of banks and a good deal of interlocking of interests has to be tolerated as a matter of practice. It may be well doubted nevertheless whether the extent to which identification of banks with particular group of business and industrial interests has proceeded in recent years bodes well for the future of our banking system. As a matter of fact, economic forces generated by the war have brought about a concentration of money and economic power which is likely to prove a grave menace to the stability and progress of our political and social structure.

Imprudent investment of funds as a cause of embarrassment to individual banks does not require any special analysis. It is not however fully realised that banking systems themselves are sometimes prone to investment trends which prove their doom in certain circumstances. This is likely to be more true of countries which have not reached their full development and in which the momentum of progress is rather high. It is less likely in a country like England which has passed the prime of economic progress and in which conditions tend to stability. Banks like other economic enterprises have to adapt

themselves to changes in economic structure or forego profits. It sometimes happens that the rise of special institutions deprives them of their accustomed outlets for investments. Sometimes, as in the United States during 1920-30, banking funds cease to flow through accustomed channels and reach trade and industry through new but indirect channels. Many a time, in the absence or decline of accepted forms of investment, banks have to cultivate loans which in other circumstances would be recorded as falling short of orthodox banking standards. The whole history of banking practice is a story of how standards of soundness and orthodoxy have changed with economic evolution. Many a time, such changes in investment of funds are reinforced by subtle changes in the character of bank liabilities. Each individual bank intent on its own profits is rarely in a position to appreciate the existence of general trends which are affecting the behaviour and fortunes of all members of a system. It is then the duty of an institution like a central bank specially charged with the supervision of all banks to keep a close vigilance on these trends and to interpret accurately the causes and meaning of what is happening. There is good cause to believe that the Federal Reserve System gravely misunderstood or underestimated the factors at work between 1921-29 and the Federal legislation on certain subjects was misinformed and misdirected. Popular prejudices and agitation confounded and darkened counsels still further. The result was a banking disaster for which there is hardly a precedent in the history of the whole world.

The weaknesses of Indian banking in the field of investment of funds are well-known. Liquid investments such as a wide and dependable money market offers are not available. The dependence on government securities has its limit in the circumscribed stock and security markets of the country. In the absence of a high degree of industrialisation, the scope for loans and advances is always narrow and it is difficult to predict what the postwar trend in this, the most lucrative asset of banks, is likely to be. The inflation of the war has introduced a fundamental change in the character of the liabilities but it may well happen that the reversal of the tendency may create problems of its own.

Failures of Monetary or Economic Upheavals

The world banking crisis of the thirties brought into light another powerful cause of banking difficulties against which even

the strongest banking systems found it hard to sustain themselves. True, the difficulties were aggravated in each country by the special weaknesses of its banking system. In Austria, it was a struggle against the uneconomic and impracticable arrangements of the Treaty of Versailles. In Germany, the unwieldy size of banks and inadequacy of technical supervision aggravated the difficulties caused by the withdrawal of foreign funds which had enabled the rehabilitation of German trade and industry almost destroyed by hyperinflation. In Switzerland, the imprudent policy of banks to grow bigger and bigger brought its penalty when the era of prosperity was suddenly reversed. In the United States, the ground for the collapse was prepared by indiscriminate participation in the great land and building boom and to a limited extent, by generous loans to the Wall Street. But it is very doubtful whether any of these weaknesses would have come to a head and precipitated a disaster but for the operation of a world-wide deflationary movement which caused a general and rapid fall of values everywhere. It was proved in this crisis that strong and concentrated banking systems are no more invulnerable against causes of this character than undeveloped and diffuse banking systems.

It is a surprising and encouraging fact that like the British banking system, the Indian banking system passed through this world-wide crisis quite unscathed. It is possible that several reasons converged to this happy outcome. It will be recalled that the main pressure of the crisis was concentrated on agricultural prices while industrial values were on the whole better sustained. As is well-known Indian banks are not much involved in the finance of agriculture except for seasonal purposes and the high protection accorded to the major Indian industries must have contributed materially to the strength of industrial values. Besides, the main line of defence of Indian banks after cash consists of government securities which appreciated enormously with the rapid fall of interest rates after the 1930-31 crisis. One or two banks operating in the rural areas appeared to be adversely affected by the undoubted impoverishment of the country-side but the high proportion of fixed deposits seems to have enabled them to maintain their existence till the inflation of the Second World War came to their rescue in a most unexpected manner.

Banking Failures & Central Banks

It is fortunate that a central bank for India was launched into existence a few years prior to World War II. No occasion has as yet arisen to demonstrate in any notable manner its effectiveness or utility. But as the problems of postwar resettlement have enterd on their acute phase, the centralisation of reserves, more elastic supply of paper and deposit currency, facilities for replenishment of cash, a proper vigilance over and assessment of banking and economic trends, periodic inspections etc. have began to appear as sources of new strength to the whole system. Central banking leadership is only partly a matter of laws but very largely a matter of traditions of skilful management and well-justified confidence. It is to be hoped that this leadership will not be lacking in the difficult times ahead.

Conclusion

In the foregoing analysis, we have indicated three main causes of banking difficulties—immaturity of banking, structural weaknesses, monetary influence like deflation, etc. Legislation is likely to prove useful during the phase of immaturity but may prove superfluous and even dangerous if carried too far in the case of a system which has reached an advanced stage of development. Except where constitutional or political obstacles are at work, structural weaknesses are very largely the outcome of banking policies which require constant examination and watchfuless on a very high plane. Monetary influences are becoming more and more matters of international policy and economics and efforts to insulate domestic economies from their operation have merely led the world to the brink of self-destruction. In the not too distant future, banking may have to cope with an altogether different force—the expanding effort of governments to bring the economic system more and more under public control. In any such goal, the control of banking must figure very prominently and the way in which each banking system responds to this new demand will prove the supreme test of its adaptability.

X

BANKING AND CURRENCY STATISTICS IN INDIA

BY

D. V. Rajalakshman

Statistical material about various aspects of economic life is mainly a bye-product of administrative activities in every country. Though the accumulation of such information commenced even long before it was known that 'all extensive bodies of data are liable to contain information on points which were not in view when they were collected', with the development of the theory of statistics and the gradual realisation of its 'ability to offer assistance in the solution of the diverse problems of national life', increased care was exercised in the collection and presentation of statistical information which, hitherto, was cabined by administrative needs. The expansion of international trade and commerce and the increased zeal not only to 'give quantitative expression to human affairs but also to plan and predict them' emphasized the need for statistical studies. But it was found that the available material fell short of statistical requirements. Committees have been appointed from time to time in different countries to go into the question and to study various problems connected with the collection and organization of statistical data. In spite of the rapid progress made during this century in improving statistical material on scientific lines, the statistical publications in many countries have never been able to fully satisfy the requirements. Dr. Bowley pointed out the unsuitability of the published material even in Great Britain, where there has been a high degree of statistical realisation by summarising the foot-notes of official publications.[1] The recent memorandum on official statistics[2] also stressed the inadequacy of the existing statistical organization in the United Kingdom and the position in other countries is not in any way different from that of Great Britain. Investigations either for verifying the accuracy of the available material or for filling in the lacunae to satisfy statistical needs have become a common feature of every country in recent years.

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[1] See the Presidential Address at the first session of the Indian Statistical Conference by Prof. R. A. Fisher.

[2] Prepared by a committee constituted by the Royal Statistical Society (1943).

Statistical awakening in India is of recent origin and, as a result, collection of proper statistics has not been done for a long time. The vast expanse of the country with her meagre communications and the unorganised state of industry and trade also hindered the collection of accurate data and the available statistical information was mainly an exudation of administrative activities. The paucity of statistical material and the inaccuracy of the existing information has been repeatedly pointed out and emphasis laid on the need for a thorough over-hauling of the prevailing system of collection and presentation of data by every committee and commission[3] appointed to study any economic problem in this country. The Indian Economic Enquiry Committee (1925) remarked that the observations of Mr. G H. Knibbs that 'to a large extent existing statistics are a side product of various government or other departments produced mainly as a sort of public advertisement of their activity or for departmental use, each acting on its own initative, the whole unco-ordinated and often without appropriate technical direction' apply mutatis mutandis to the conditions of India. More than a decade later Bowley and Robertson commenting on statistical information in the Scheme for an Economic Census of India (1934) remarked that 'though in some branches careful work is being done and determined efforts made to improve the accuracy and scope of information, in others they are unnecessarily diffuse, gravely inexact, incomplete or misleading; while in many important fields general information is almost completely absent'. Information usually has not been available for many a crucial problem that needs statistics to present a directive and throw light to evolve a solution and even if available has been invariably inaccurate and defective. Statistics *qua* statistics never received proper attention either from the Government or from the people and as a consequence Indian Official Statistics 'have always been marked by a series of compromises not only between what is ideally desirable and what is actually obtainable but also between statistical needs and administrative purposes'.

But for the slip-shod statistics published by the various departments of the government to suit their administrative needs, no systematic attempt was made in India till 1871 to compile

[3] Reference can be made to the comments on the available statistical material in the Reports of the Banking Enquiry Committees (Central and Provincial), Royal Commission on Labour, Royal Commission on Agriculture and other similar reports.

statistical information on scientific lines. Although the post of the Director General of Statistics was created in this year, attempts to seive out statistical material and issue consolidated publications were made only in the early part of this century. The Director General was first allowed to review the reports issued by the various departments. The publication of statistics under the general guidance and control of the departments concerned was entrusted to him only after the organization of the Statistical Bureau in 1895. Later it was merged into the office of the Director General of Commercial Intelligence and Statistics established in 1905 and separate publications containing statistical information commenced only with the creation of this department. To enable the department to function efficiently commercial intelligence and statistics were bifurcated and a separate department of statistics was created in 1914. But this was only ephemeral and as a measure of retrenchment they were again amalgamated in December 1914. The same arrangement continued except that in 1933 a Statistical Research Bureau was established at the head-quarters of the Government of India for the analysis and interpretation of economic and statistical material and for conducting ad hoc statistical surveys. This branch which was later separated, has since 1938 been functioning under the supervision of the Economic Adviser to the Government of India. The Director General was assisted by two Deputy Directors, one for Commercial Intelligence and the other for Statistics, but these posts have been occupied recently by two directors, one designated as the Director of Commercial Intelligence and the other as the Director of Statistics. This separate organisation set up to collect and publish statistical information sustained various vicissitudes of neglect and retrenchment since it was considered for a long time as superfluous and not as an essential requisite for the development of national economy. This department at present confines itself to the collection and dissemination of information about trade for the use of Indian firms besides the compilation of all-India Statistics. During the last two decades definite progress has been made not only in improving the statistical publications of the Department of Commercial Intelligence and Statistics, but also in expanding the statistical set-up of various departments at the Centre and in the Provinces. Still the published material is inadequate and in some branches inaccurate. The factual material is not properly mobilised to suit

statistical requirements and the publications are usually delayed in such a way that the current importance of the material is often lost, making it out of date by the time it is available.

Statistical material about banking and currency in India stands unique not only in respect of the mass of information but also in its mobilization and publication. The establishment of the Reserve Bank of India is as much a landmark in the history of the progress of banking and currency statistics as it is in the financial history of the country. The fusion of currency and credit brought about by the creation of this apex bank in 1935 enabled the filling up of several deficiencies which existed in the banking and currency statistics. The Reserve Bank 'acting as an agency for the collection and dissemination of financial information and statistics' gave an impetus to the improvement of statistical information. Remarkable progress has been made during the last ten years in the collection and immediate publication of statistical information which eschews most of the defects in the available data on different aspects of economic life. In studying the development of the banking and currency statistics a clear distinction has to be made between the pre-Reserve Bank period and the later period as there is not only a tangible increase in the available material but also a co-ordination among the publications which was totally lacking before. The Reserve Bank besides expanding the scope of previous publications also commenced issuing new reports to provide adequate material about different aspects of monetary conditions in the country.

Currency and credit functioned independently, the one under the complete control of the Government and the other as a private enterprise without any effective supervision till the formation of the Reserve Bank. Consequently statistical information about banking and monetary problems were collected, compiled and published separately without proper co-ordination. The importance of currency brought in its wake long ago the necessity of collecting statistical data regarding monetary problems, although the operations of the credit system and the compilation of banking statistics had been comparatively of recent origin. The snail-pace development of trade and the lack of integration of internal markets kept credit only in the backgroud. As a result the expansion of the credit structure and the development of banking institutions run on modern lines has hardly been a century old in this country.

"The publication of statistical information about currency matters never came within the compass of the Department of Commercial Intelligence and the material was mainly embodied in the annual report of the Controller of Currency till its publication was taken over by the Reserve Bank. Statistics of banks were collected by the Department of Commercial Intelligence and the available information was published annually in the Statistical Table relating to Banks in India. These were the two annual publications containing exclusively information on currency and banking problems before the creation of the Reserve Bank and a large portion of the available material was included in them. The Reserve Bank not only expanded the scope of these volumes but started fresh weekly, monthly, and annual publications with a view to providing comprehensive details about the currency and credit operations in the country. Besides these, some of the publications of the Department of Commercial Intelligence and other official reports contain information on banking and currency problems. A list of the important official publications giving statistical information is included in Appendix I.

Till 1914 the annual report containing a review of the monetary situation with some statistical statements relating to the fiscal year was issued by the Comptroller and Auditor-General under the title 'The Report on the Operations of the Currency Department; the Movement of Funds and on Resource Operations of the Government of India'. The control of currency and resource arrangements, public debt and other ancilliary matters which belonged to this report were made over to the newly-created Controller of Currency in 1914, while the corresponding work in the provinces continued to be performed by the Accountant Generals under the supervision of the Controller. The first issue published by him was for the year ending March, 1914, and this report was issued annually till 1919 along with the separate provincial currency reports. It was soon realised that important currency questions in their relation to India's trade cannot be adequately discussed as provincial matters and since the essential provincial statistics were incorporated in this volume, with a view to avoiding repetition, it was decided to suspend provincial reports and include in this publication any local details which were of special interest. The first issue of this series was published for the year 1920-21 and later the title was shortened as the "Report of the Controller of

Currency." Till the creation of the Reserve Bank this annual publication which was issued at the end of each financial year contained two distinct parts, the one having a general review of the monetary situation and foreign trade, and the other consisting of statements giving relevant statistical information. Although alterations were made from time to time in the sub-heads under which the review is made and in the material included in the tables, to suit the needs of expanding trade and commerce and of various currency problems that presented themselves, this publication retained the same form throughout. The last report issued by the Controller was for 1934-35, the year prior to the organisation of the Reserve Bank. The introduction of this volume dealt with the general features and Indian Government Finances, and the first part embodiet a review for the year in eight sub-heads, namely, foreign trade, bullion, exchange and remittances to the Secretary of State, the government balances and reserves, money conditions in India, public debt, demand for the various forms of currency, the note circulation and miscellaneous matters connected with currency notes and coinage, besides forty-one statements on trade and monetary conditions in the later half of the publication.

Consequent on the transfer of the control of currency to the Reserve Bank, this publication was suspended as it was considered unnecessary in view of the fact that the Bank commenced issuing 'an annual report and a monthly and annual statistical summary.' As these publications, based on the calendar year, varied widely in form from the Report of the Controller of Currency, it was decided later to revive this annual publication with a view to retaining statistical continuity. The Reserve Bank published the first report in 1937 giving a review of the two financial years, 1935-36 and 1936-37, under the title "Report on Currency and Finance." This volume was based on the previous currency reports, with a brief commentary on the statistics included and on other minor alterations as were entailed by the changes in the cicumstances brought about by the creation of the Reserve Bank. This report comprises of a review of trade and various monetary problems under different sub-heads besides giving thirty-six statements in the later part of the volume. Although it was designed to publish this review annually soon after the close of each financial year, only a few reports were issued without delay (till the report for the year 1941-42),

and due to the extraordinary conditions of paper scarcity and other difficulties during war time, considerable delay was evinced later in publishing this volume.

Minor changes have been embodied with a view to widening the scope of this publication and at present this report contains comprehensive information about monetary conditions in the country. In the first part a review under the various sections of trade, bullion, exchange and remittance, exchange control, public finance, Government balances and reserves, public debt, currency, miscellaneous matters connected with coinage and currency, and money and banking is given besides a note on the general features of the year. The second part consists of statements showing the relevant statistics about the various aspects reviewed in the first section. The tables contain details about index numbers of wholesale (including those of primary commodities) and cost of living, balance of trade in merchandise, highest, lowest and average prices of gold in London and Bombay, average quantity and value of gold coin and of imports and exports of silver (private and Government), prices of silver in London, New York and Bombay, exchange-rates of telegraphic transfers, purchases of sterling by the Reserve Bank, provincial government budgets and their consolidated debt position, subventions and other payments made by the Centre to the provinces, central and provincial governments' balances in India with the Reserve Bank and at government treasuries, Government of India three months' treasury bills, sales of provincial Government treasury bills, Government of India ways and means advances and treasury bill transactions, public debt (rupee and sterling debt), prices of representative securities of the Government of India, post-office cash certificates and savings bank, note circulation, absorption of small coins, seasonal absorption, annual absorption of currency, (monthly figures for the current year are shown separately), circulation of notes by denominations, whole rupees coined and issued from mints, Indian money-rates, issue and banking departments of the Reserve Bank, notes in circulation, scheduled banks' consolidated position, clearing house statistics (number and amount of cheques cleared in each circle), remittances through the Reserve Bank, Imperial Bank and treasury agencies and encashment of foreign circle notes.

A detailed study of the review and statements included in this report, reveals the vast amount of statistical information available about various aspects of currency problems in India. Although the scope of this publication has been enlarged and more statistical material has been included after the Reserve Bank undertook its publication, ever since the issue of the report by the Controller of Currency, it contained a bulk of statistical information. The form of the report has been retained throughout and no undue delay has been made in its publication. Immediate cognisance of fresh problems arising now and then has been taken by the authorities having control over currency and the necessary alterations have been incorporated in this publication to suit those requirements.

Though the statistics of currency are almost complete and available from a long time, statistical material about banking institutions is inadequate, and even the existing information is available only for a few years. Considerable progress has been made in the collection of statistics regarding banks after the creation of the Reserve Bank, but much remains yet to be done for presenting a clear picture of the credit structure of the country. Although currency was under the complete control of the government before the establishment of the Reserve Bank, there was very little supervision over credit and banking institutions which were not bound to provide full information about their business and the few details given by them were merely optional, not obligatory. Consequently the devolopment of currency and credit statistics was totally lopsided; there was adequate statistical information about currency, whereas statistics of banks were meagre.

The collection and publication of the available banking statistics was entrusted to the Director-General of Commercial Intelligence and the first volume was issued in 1916 furnishing details for the calendar year 1913 under the title 'Statistical Tables relating to Banks in India.' Till 1938 the compilation of this annual report with the statistics of banks for the calendar year was done by the Director-General and the publication was later continued by the Reserve Bank of India. The object of this publication has been to show the available statistics relating to banks in detail and in a summary form. This volume was divided

into two sections showing summary tables and general tables besides a short introductory memorandum. All the information available about the three Presidency Banks, the exchange banks and the Indian joint-stock banks, classified according to those which had a paid-up capital and reserve of five lakhs and over and those having between one to five lakhs, and details of bank failures were incorporated in this volume. While the first two issues of the publication contained only such banking statistics, subsequent reports for the years 1916, 1917 and 1918 had a large number of tables dealing with monetary conditions. These tables were excluded from 1919 thus confining the report only to banking and clearing house statistics and the introductory memorandum was replaced by a preparatory note. This note contained an explanation of the tables included in the volume and the Report of the Controller of Currency was referred for an account of monetary conditions. Consequent on the amalgamation of the Presidency Banks,[1] the summary tables showing the position of the three presidency banks were replaced by that of the Imperial Bank and an additional statement providing details about the position of the Imperial Bank was included in the general tables from 1921 (published in 1923). Subsequently two tables in the first section of the publication showing the position of the exchange banks grouped according to the extent of business in India and that of joint-stock banks according to the amount of capital, were deleted and in their place two tables one in each part of the report showing the position of the co-operative banks at the end of the provincial co-operative year were included. Statistics given in these statements related to all provincial and central co-operative banks and registered non-agricultural (urban) cooperative credit societies with limited liability and with a capital and reserve amounting to at least one lakh of rupees. These banks were also divided like the joint-stock banks as those with capital and reserve of five lakhs and over and those with a capital ranging between one and five lakhs. This publication containing six tables in the first part and ten in the second together with two appendices giving details of the banks and their branches and agencies in India, London offices, agents or correspondents doing business in India, was issued annually till the formation of the Reserve Bank. Consequent on the creation of this apex bank, a number of alterations were made in the report for the year

[1] The Imperial Bank was formed on 27th January, 1921.

1935 (published in 1938). An additional statement showing the affairs of the Reserve Bank was included in the summary tables. The statements giving the position of the three presidency banks and the Imperial Bank were deleted from the second part of the report and the table showing the average bank rate of the Imperial Bank was shifted to the first section. The report thus contained thirteen tables, eight in the first part and five in the second, with two appendices. This arrangement continued till 1938 (published in 1941) with the summary tables having statistical information about the position of the Reserve Bank, the Imperial Bank, the Exchange Banks, Indian joint-stock banks and the proportion of cash to liabilities on deposits of the several class of banks together with information about the position of cooperative banks and details about bank rate. In addition to these general tables pertaining to bank failures, amount of cheques cleared from the Clearing Houses, available information about the position of exchange banks, joint-stock banks and the Indian cooperative banks were also given in the second part of the report.

The publication of this volume was transferred to the Reserve Bank as it was felt that this institution, being the central banking authority of the country, was the proper agency to issue the report. As most of the information contained in the publication was being collected by the Reserve Bank in the course of its business, this would avoid a considerable amount of duplication of work. The Reserve Bank issued the first publication in 1941 containing information for the two calendar years 1939 and 1940 under the title "Statistical Tables relating to Banks in India and Burma." Although care was taken "to see that statistical continuity is maintained as far as possible with the previous publications of the Director-General of Commercial Intelligence." A number of changes were made for meeting the many existing deficiencies and for incorporating the available statistical material secured by the Reserve Bank by virtue of its control over the banking institutions. Certain tables were recast and amplified to furnish greater details of the position of the several classes of banks. Since the inauguration of the Reserve Bank, banking institutions have come to be divided into two main classes, namely, scheduled banks,[5] those institutions included in the Second Schedule to the Reserve Bank

[5] The conditions which a bank must fulfill to be classed as a scheduled bank are laid down in Section 42 (6) of the Reserve Bank Act.

Act, and the non-scheduled banks comprising those that have not been so included. According to the provisions of the Act, the Reserve Bank exercises a control over the scheduled banks and secures full details about their business. As these banks have capital and reserves amounting to over 5 lakhs and have been occupying in recent years a predominent position in Indian banking, information about them has been shown separately in the general tables giving the details of balance-sheets. Although the statutory control of the Reserve Bank has been confined to scheduled banks, the bank keeps in touch with the non-scheduled banks and collects information regarding their business. The Indian Companies Act was amended in February, 1938, following the request of the Reserve Bank, so that a copy of the statutory returns furnished by the various banking companies to the Registrars of Joint-Stock Companies could be secured by the bank for information.[6] Consequently the Reserve Bank is in a position to provide statistics of all the banking institutions in the country. Statistics in respect of smaller banks having a paid-up capital and reserve of less than one lakh have been collected for the first time and included in the annual publication in order to make the Indian banking statistics as complete as possible.

Besides bringing up-to-date the details regarding banks and their branches published in the Appendix, three fresh appendices have been added, the first of them giving the names of members and sub-members of clearing houses. Since 1st October, 1940, the Reserve Bank has introduced a new scheme of remittance facilities which has been extended to approved non-scheduled banks and indigenous banks. The two appendices at the end of the publication give a list of non-scheduled banks and indigenous bankers approved for concession rates of remittance and the rates charged thereunder. The second issue of the report published in 1942 containing figures relating to the calender year 1941 includes the same details except for a few alterations. More details about banking companies which went into liquidation were included besides the details of the branches of cooperative banks

[6] The Reserve Bank receives a copy each of the cash reserve returns and balance-sheets filed by banking companies under section 277 (4) and 134 of the Indian Companies Act.

in the first appendix. Consequent on the paper scarcity and other difficulties of publication felt during war-time the report was suspended but was again renewed in 1944. The report published in that year covered the two calendar years 1942 and 1943.

Inordinate delay in publication of the statistical tables was one of the important criticisms levelled by the Central Banking Enquiry Committee.[7] Till the publication of this report was taken over by the Reserve Bank there was at least an year's delay. But the Reserve Bank was able to rectify this defect by issuing promptly the first volume in 1941 and the second in 1942, soon after the end of the calendar years to which the statistics refer. The later delay was mainly an outcome of the extraordinary circumstances prevailing during war-time and, with the termination of the war, it has again been possible for the timely publication of this report at the end of each year.

The first part of the report giving summary tables includes information about the issue and banking departments of the Reserve Bank, consolidated position of the Imperial Bank of India, exchange banks divided according to those doing a considerable portion of their business in India and those which are merely agencies of large banking corporations doing a major portion of their business abroad, principal Indian joint-stock banks (classified according to paid-up capital and reserve; those having five lakhs and over, between one and five lakhs, between Rs. 50,000 and one lakh, and below Rs. 50,000) and the Indian cooperative banks having capital and reserves of over 5 lakhs and those having between one and five lakhs together with a table showing the comparative position of the several classes of banks as regards their paid-up capital and reserves, cash balances, investments and loans, and advances in relation to their deposits. Details are also given about the demand and time liabilities, advances and bills discounted by scheduled banks, demand and time liabilities and cash balances of non-scheduled banks and the average bank rate of the Imperial Bank, the Reserve Bank, the Federal Reserve Bank of New York and the Bank of England. The general tables included in the second section incorporate details about liabilities and assets as published in the balance-sheets of exchange banks, Indian joint-stock banks

[7] Report of the Indian Central Banking Enquiry Committee (1931), Volume I, Part I (Majority Report) p. 431.

classified as scheduled banks, non-scheduled banks having paid-up capital and reserves of 5 lakhs and over, and those having paid-up capital and reserves between 1 and 5 lakhs and between Rs. 50,000 and 1 lakh. Information is also given about the capital, reserves, deposits, loans and cash balances of the Indian co-operative banks during the past 3 years classified according to those having a paid-up capital and reserves of over 5 lakhs and those having between 1 and 5 lakhs besides including a statement showing details of liquidation of Indian joint-stock banks. The total amount of cheques cleared through clearing houses are also included in this section of the report. The publication also contains appendices giving information about the banks and their branches, sub-offices and pay offices in India, London offices, agents or correspondents of certain banks and firms, list of members of clearing houses, list of approved non-scheduled banks and indigenous bankers eligible for concession rates of remittances and the rate of telegraphic transfers, bank drafts and mail transfers charged under the scheme of remittances.

Besides thee two important annual publications, statistical information about coinage and working of mints is given in the administration reports of the mints at Calcutta and Bombay and a review thereof, published every year by the Finance Ministry of the Government of India. These contain in the introductory notes information about the new receipts of gold and silver, operative loss and counterfeits, and the total number of pieces coined and the value of silver, nickel and bronze coins minted. The report on the working of the Calcutta Mint gives details about gold and silver held on treasury account and about coinage, operations on the silver stock account, operative loss and also about bronze and copper coinage. Miscellaneous information about the activities of the various departments is also given with appendices showing profit and loss account, balance-sheet, and other works done at the mint together with the tale and value of coins minted, counterfeit coins and about various offences committed against the Coinage Act. The report of the Bombay Mint also gives the same details, with a table showing amount of gold and silver received from the public and melted for assay. It also gives information about gold received from the mines for purposes of refining and a report containing details about various metal assays carried out in the mint.

Before the constitution of the Reserve Bank with the diversified control of currency and credit, the money market remained imperfectly organized and as such it was difficult to secure frequent and complete information about the general banking and monetary position. But the creation of the Reserve Bank obviated to a great extent this difficulty and according to the statutory provisions of the Reserve Bank Act the bank issues a large number of publications containing statistical information about banking and currency besides continuing the 'Report on Currency and Finance' and the 'Statistical Tables relating to Banks.' Weekly statements of the Issue and Banking Departments are published separately[8] besides issuing a consolidated statement[9] of the returns received from the scheduled banks under section 42(2) of the Reserve Bank Act every week. The annual balance-sheet of the bank is also published in the same form as the weekly statement, but a statement of the profit and loss account is also appended to it. The Reserve Bank also compiles the statistical summary issued monthly containing, in a concise form, statistics on banking and currency, besides publishing the Annual Report of the Central Board of Directors in terms of section 53(2) of the Act. The Reserve Bank has also begun to publish a monthly *Reserve Bank of India Bulletin*, which is a highly useful publication.

The Annual Report is mainly a review of the working of the bank with a brief reference to money and financial conditions. The latest balance-sheet, profit and loss account, and the auditor's report are also included in it. Although the report contains a short survey of money, exchange and bullion markets and also deals with economic and banking conditions, it cannot be considered of statistical significance as no detailed information about banking and monetary conditions are given in this publication. The weekly statements of the Issue and Banking Departments which are reproduced in the leading financial and other periodicals, indicate the position of the bank for the week ending on Friday and is an important pointer to the conditions prevailing in the money and financial markets every week. The statement showing the position of the Issue Department contains figures of notes held in the Banking

[8] Under section 53 of the Act, the Bank transmits to the Central Government every week, a statement of its accounts in the Issue and Banking Departments.

[9] This statement is issued under the statutory provisions of section 43, of the Act.

Department and notes in circulation under liabilities, whereas details of gold coins and bullion, sterling securities and rupee coins are shown as assets. The percentage ratio of total gold (coins and bullion) and securities to total notes issued is also given in the statement. The statement of affairs of the Banking Department contains details of paid-up capital, reserve fund, deposits, bills payable and other liabilities, under liabilities, whereas for assets information is given about notes, ruppee coins, subsidiary coins, bills purchased and discounted, loans and advances, investments and other assets. The other weekly publication showing the consolidated position of scheduled banks for the week ending Friday, contains information about demand and time liabilities, cash (currency notes, rupee coins and subsidiary coins), balances with the Reserve Bank, advances and bills discounted in India. This publication also includes a comparative statement giving figures for 4 weeks, the current, the previous, the corresponding week of the previous year and the pre-war week (week ending 1st September, 1939).

'The Statistical Summary' issued every month is the most important publication giving statistics at frequent and regular intervals on banking and monetary problems. This contains information about banking and monetary conditions in India and is generally published in the third week of the month. Ever since its publication minor alterations have been made not only in the matter but also in the manner of presentation of the tables for including complete and relevant statistics in a compact form. This publication contains information[10] about currency, consolidated position of scheduled banks, the assets and liabilities of the Issue and Banking Departments of the Reserve Bank, gold and silver prices, foreign exchanges (Bombay on London and New York, London on New York, and New York on London), purchases of sterling by the Reserve Bank, movement of funds by bank telegraphic transfers issued and encashed at offices and branches of the Reserve Bank, clearing house returns, wholesale prices, cost of living and security prices, Government of India security prices, Government of India treasury bills and ways and means advances, Government of India treasury bills and the dates of their maturity, and short-term money rates. Usually monthly figures and annual averages for some previous years are also given in this summary.

[10] At present the Statistical Summary includes fourteen tables containing statistical material.

Apart from these publications which contain exclusively statistical information about banking and currency, considerable amount of statistical material is also available in some of the reports issued by the different Ministries of the Government of India. The most important among such reports is the Statistical Abstract for British India published annually by the Director-General of Commercial Intelligence and Statistics, containing a compendium of statistical information on about every aspect of economic activity. Figures pertaining to a decade are given in every volume and the first volume was published in 1923 containing statements covering the decade 1911-12 to 1920-21. Prior to the commencement of this publication the Director-General of Commercial Intelligence and Statistics used to issue 'Statistics for British India' in five volumes containing statistical information and the India Office, London, used to publish the volume "Statistical Abstract relating to British India." Both these publications were replaced by the 'Statistical Abstract' and statistical continuity was retained with the publication of the London Office. Ever since its inception information about monetary conditions has been included under the two sections of banks, coinage and currency. Alterations were made from time to time in the manner of presentation of statistical material in these sections so as to accord with the information that could be secured. Tables relating to banking and monetary conditions are included in the two sections, one on exchange, coinage and currency and the other on banks, while statistics of post office savings banks[11] are shown in the section on Post, Telegraph and and Telephone. The section on banks contains two statements,[12] one showing the progress of banking capital in India and the other giving the proportion of cash to liabilities on deposits of the several classes of banks. Four separate tables are included in the first statement showing the position of the Reserve Bank, the Imperial Bank and joint-stock banks having a paid-up capital and reserve of Rs. 5 lakhs and over, and exchange and co-operative banks; whereas in the second table figures are given separately for Imperial Bank, exchange banks und joint-stock banks for ten years. In the section on exchange, coinage and currency a large number

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11 These are compiled from the annual report of the Director-General of Posts and Telegraphs.

12 Taken from 'Statistical Tables relating to Banks in India.'

of tables[13] are included containing information culled from various reports.[14] Details are furnished about gold standard reserve, silver redemption reserve, purchases and sales of silver, purchases and sales of sterling by the Reserve Bank, Government promissory notes enforced for payment of interest in London, exchange on London, Bank of England rate of discount and Reserve Bank's rate of interest, rate of exchange between Calcutta and Hongkong, telegraphic transfer selling rate for exchange (Calcutta on Japan), prices of principal kinds of Indian Government stock, selling prices in Calcutta, prices in London, prices in London of standard silver, of sovereigns and uncoined gold in India, of gold in London and Bombay, of bar silver in Bombay, imports and exports of gold and the amount received and the amount coined in the mints, quantity of gold and silver imported into and exported from British India to foreign ports, number of coins and value of money coined at the Calcutta and Bombay mints, old Government of India rupees (inlcuding small silver coins) received into the mints for recoinage and silver coinage in each mint, number and value of currency notes of each denomination in circulation and composition of the paper currency reserve, together with information about receipts, charges and net profits of the currency department. In the section on Post, Telegraph and Telephone there is a table showing details about the number of post office savings banks, depositors and amount of deposits.

The publication of Statistical Abstract was temporarily suspended due to war-time difficulties, after the issue of the 18th volume in 1942 which contained information for the period 1930-31 to 1939-40. This publication is of immense utility not only for studies on banking and currency but also for an understanding of every economic problem.

Another publication that contains statistical information about banking is the Annual Report of the Posts and Telegraphs Department. This contains information regarding post office savings and the sale of post office cash certificates. Details

13 The 18th issue published in 1942 contains twenty-three tables.

14 Some of them are the combined financial and revenue accounts of the central and provincial governments in India, report of the controller of currency, information furnished by the Reserve Bank, accounts relating to sea-borne trade, returns from mint masters and reports of the Finance Ministry,

about the number of accounts, deposits, withdrawals and other particulars are given about the savings bank and the denomination of certificates issued and discharged, the cost price realised and the amount paid are specified for cash certificates.

Statistical material about banking and currency is included in the 'Monthly Survey of Business Conditions in India' issued by the office of the Economic Adviser to the Government of India. This is being published every month ever since 1932 and contains information about prices, industrial production and other business conditions in two parts. "The first part consists of separate notes dealing with the various economic aspects and also gives a monthly account of economic conditions; the second gives the necessary general statistical data dealing with production, trade and financial conditions." A section is devoted in Part I of the publication to the review of the financial position ; and relevant statements are shown in Part II. Monthly figures of cheque clearances, consolidated position of scheduled banks, index numbers of prices of Indian securities and a short note on these matters are given in Part I besides a note on the remittances to England by the Reserve Bank. The financial statistics given in Part II of the Survey include monthly figures of bank rate, average exchange rate, notes in circulation, central Government treasury bills sold to the public and in favour of the Issue Department of the Reserve Bank, cheque clearances, security index number (fixed yield Government paper, fixed yield industrial securities and variable yield securities). The percentage variation as compared with the same month of the previous year is also given for every item.

The Indian Trade Journal which is issued every Thursday by the Department of Commercial Intelligence and Statistics with the main object of providing information about trade to the business community, contains some statistical material regarding banking and currency in the section on 'Money and Bullion Markets.' Besides reproducing the weekly statements of affairs of the Issue and Banking Departments of the Reserve Bank and the statement of the position of scheduled banks, it gives details in this section of the publication about bank-rate, Government of India treasury bills, security prices (Calcutta and London), exchange (telegraphic transfer selling and buying) and prices of gold and silver in the bullion market.

Besides the important official publications mentioned above, statistical information about certain aspects of banking and monetary problems is also found in other reports[15] issued by different Ministries of the Government. In addition to these publications which are improved and are increasing with the expansion of trade and the integration of money markets, a number of periodicals have been started which are devoted specially to the study of various monetary problems.

Journals dealing with problems related to economic conditions usually include financial reviews giving information of stock exchanges, money markets and other monetary problems. Special supplements on banking and currency are also issued occasionally by some of the periodicals. The current statistical material included in journals is usually the reproduction from the official publications, but there are a few periodicals in which data taken from official publications are reorganised and presented with the relevant information about other countries like United States of America and Great Britian to facilitate comparative studies.

The Indian Institute of Bankers, organised two decades back (1926), mainly to promote interest in the study of banking and currency problems issues a quarterly publication. Statistical material is being included in this journal from 1941 and at present some current statistical tables with a financial review are published in this ptriodical. It is not posssible to provide a complete account of the statistical information included in every journal and, as such, a list of some important periodicals and other publications containing statistical material about banking and currency is given in Appendix II. All leading banks publish balance-sheets giving full details about their position at the end of every year. Besides these, financial reviews and conditions of Indian and foreign money markets are published in important newspapers to facilitate business and trade.

The gradual expansion of international trade and commerce in this century has integrated the money markets of different

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[15] Refer to the monthly and annual publications on Joint Stock Companies in India, and reports like 'Review of Trade in India' and 'Statistical Statements relating to Co-operative Movement in India.'

countries, so that the monetary policy of a nation is sure to have its repercussions on the financial structure of other countries. As such it is not possible to disentangle and study independently the currency and credit problems of any country without considering the international monetary conditions. A knowledge of banking and currency statistics of different countries will also be useful for purposes of international comparisons. Since formerly the League of Nations was, and now the United Nations Organization is the only organisation to collect, compile and publish international statistics, a short note is given in Appendix III about the information on banking and currency contained in its publications.

An analysis of the existing statistical information on banking and currency in India creates the impression that it is comprehensive and even exhaustive. Although a rapid progress has been made in this century in the collection and publication of monetary statistics, particularly after the establishment of the Reserve Bank, there is still scope for improvement. Attempts will have to be made to fill in the lacunae in the available material to fully serve the statistical requirements, besides gathering fresh information with a view to providing sufficient material for the study of various problems that arise from time to time.

Lack of coordination, inordinate delay in publication, gaps in the available statistics and their inadequacy to satisfy the requirements for various studies, are the major deficiencies of the banking and currency statistics available in the Indian Official Statistical Publications. Delay in publication had never been a serious charge against statistical material regarding monetary problems although the inordinate delay in the issue of banking statistics was deplored by the Central Banking Enquiry Committee. The 'Statistical Tables relating to Banks in India' was usually delayed by two years but after the Reserve Bank undertook the publication of this report attempts have been made to bring out this volume without delay. All the other reports on banking and currency issued by the Reserve Bank are published promptly at stated periods. Even the government reports giving statistical information are issued regularly, the only exception being the yearly publications of the Department of Commercial Intelligence which are delayed to some extent. It is possible to minimise this delay and to increase the

utility of the material for the study of various questions of currency and banking. War-time scarcity of paper led to the temporary suspension of some of the publications and even those issued were unduly delayed and considerable reduction was made in the size. But this was only transient and since the end of the war many of the publications are being restored to their pre-war position and attempts are being made to issue them without delay. The gradual evlution of the modern monetary technique and the expansion of business and trade in recent years has made it more important than ever that regular and complete information at frequent intervals should be available showing the banking and monetary position in the country. As such all publications of the different institutions, besides the official reports containing statistical information on banking and currency, are also issued without involving any undue delay. The publication of banking and currency statistics in India as at present may be considered to be free from the criticism of the inordinate delay in publication.

Lack of coordination in the published material has however been a serious defect in the banking and currency statistics. The uncoordinated nature of the statistical material before the Reserve Bank came into the field, was largely due to the lack of unified control over currency and credit, the unorganised condition of the money market and the collection and publication of statistical material by different authorities. But the Reserve Bank created with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage, facilitated the compilation of statistics to be undertaken by a single institution and gave scope for sufficient adjustment to bring about coordination among the publications containing various banking and currency statistics.

The criticism that was often levelled against banking statistics before the inception of the Reserve Bank. was that of paucity of published material. But in so far as monetary statistics were concerned, except for some alterations that were required to be made frequently with the expansion of business and trade, the information available was considered to be almost complete. The dearth of statistical information about banks was stressed by the Central

Banking Enquiry Committee[16] and by Mr. A. D. Shroff[17] in his evidence to the Committee. But remarkable progress has been made in recent years. Fuller information has been published in recent years in the annual reports and the balance-sheets of individual banks besides the publications of the Reserve Bank. The Reserve Bank has succeeded in rectifying most of the deficiencies by the Central Banking Enquiry Committee, except those relating to Exchange Banks and Indigenous Bankers. The Reserve Bank is statutorily empowered to obtain detailed information from the scheduled banks and although no direct control is exercised over the non-scheduled banks, still the bank keeps in touch with them. Besides providing information about non-scheduled banking concerns whose capital and reserve resources exceeds one lakh of rupees, the collection and compilation of statistics of banks with capital resources less than one lakh which was not available before has also been undertaken by the Reserve Bank.

The exchange banks which have the virtual monopoly of financing the foreign trade of India are incorporated outside India and the lack of information about their Indian business has been for a long time a serious gap in the banking statistics. Mr. Manu Subedar commenting on the inadequacy of published statistical material in this respect remarked that "its paucity, its misleading character through everything being lumped together and the absence of other details, detracts from its usefulness."[18] It was in 1923 that a distinction was made between the exchange banks doing considerable part of their business in India as against those whose banking operations were done mostly abroad. But these banks are not required to publish separately figures relating to their business in India though figures of their Indian deposits and cash balances are, as a matter of coursesy, supplied in a consolidated form for all the banks to the Director-General of Commercial Intelligence and Statistics. No material alteration was made in the collection of detailed information about these banks even after the establishment of the Reserve Bank and the balance-sheets of these banks furnish details of their total business which cannot be utilised to study problems of Indian banking. As a clear understanding of the Indian banking position is not possible without precise informa-

16 Report of the Central Banking Euquiry Committee, Vol. I, Part I (Majority Report), p. 431.

17 Ibid, Volume II, Evidence, p. 409.

18 Ibid, Vol. I, Part II (Minority Report), p. 172.

tion regarding exchange banks, it is essential that statistics exclusively concerned with the operations of the exchange banks in India should be published separately.

The other category of credit institutions about which no information is available is the Indigenous Bankers. As a credit agency that has stood the test of the economic vicissitudes for centuries, indigeneous bankers hold a unique position with regard to the magnitude of their operations and their importance to society. The Reserve Bank exercises no control over this constituent part of banking and the present position is not far from what existed at the time the Central Banking Enquiry Committee had its findings and was "greatly struck by the absence of published statistics in regard to the operations of indigenous bankers." Though the Reserve Bank is trying to bring indigenous bankers within its fold by extending remittance facilities to non-scheduled banks and also to approved indigenous bankers, still it should exercise sufficient control over this section of banking institutions in this country, if it is to discharge its responsibility of satisfactorily handling the currency and credit policies of the country. Though the Agricultural Credit Department of the Reserve Bank is meant to study special problems connected with rural finance and give advice to the cooperative banks, still the Reserve Bank's credit policy will have little effect so far as agricultural credit is concerned unless the indigenous bankers are brought within the banking structure. An effective regulation of indigenous banking will incidentally facilitate the collection of adequate statistical information.

Besides, there are some minor omissions in the published material that have to be rectified. Statistics of scheduled banks do not give details of their investments and of the proportion of these to total liabilities. The figures about bond portfolio of banks are also not so satisfactory or comprehensive as the statistics about other items. Further, the annual publication about banks does not furnish separate figures for Government securities and detailed statistics of banks' earnings are also not available.

In order to widen the scope and utility of statistical material it is necessary to collect information about bank deposits and advances. Bowley and Robertson in their scheme for an economic census suggested that the Reserve Bank should publish a single consolidated account, twice a year, of the advances classified as

far as possible, not in accordance with the type of security taken but in accordance with the purpose for which the advance is being used. Tentative sub-division into seven groups was also suggested by them. But till now no such attempt has been made by the Reserve Bank. The Reserve Bank with its wide powers of prescribing the returns to be submitted by the scheduled banks, can secure such periodical information from these banks without any difficulty. Although it is not easy to demarcate exactly the purpose, the advances can be at least classified according to the broad divisions of industry, trade, agriculture and the like. In view of the large seasonal swings in different sectors of Indian economy it will be of great help if such figures are published every quarter.

Equally important is the information about the manner in which bank deposits are distributed. This will be useful in clearing up some part of the obscurity which surrounds trade cycles. It will not also be possible to formulate suitable policy for utilising all the available resources to the best advantage without having a precise idea of the manner in which bank deposits are distributed. Such investigation of the bank deposits must be conducted by the Reserve Bank periodically. So far as the scheduled banks are concerned, the Reserve Bank can insist upon their submitting a half-yearly or annual statement of the ownership of deposits. The collection of statistics of non-scheduled banks may be the difficult part of the work and this can form part of the annual publication. This periodical investigation cannot be considered as an inquisitorial method of getting information of a private character. What is required is only the total of individual and corporate deposits with each one of the banks. On the basis of these details the Reserve Bank can make a distinction between the persons and firms with bank-balances and also between the small and big banking units with a view to assessing the importance of large and small deposits. This information can be included in the 'Statistical Tables relating to Banks.'

The available statistical material about the capital market of India is also very meagre. Practically no attempt has so far been made to assess the movement of even that part of private capital which is represented by the issue of new securities.[19] It is necessary to estimate the mobility of private capital in connection with

[19] Refer to 'A Scheme for an Economic Census of India (1934),' p. 55.

India's balance of payments and the information collected may be published in the annual report of the Reserve Bank and reproduced in the *Review of Trade*.

The Reserve Bank by virtue of its management of currency and control over the credit structure has a considerable hold over the entire gamut of economic organisation. The Bank must be able to collect all relevant facts and figures about every phase of the economic life of the country and with this information should prepare at the end of every financial year a balance of account of the country so that it may give a bird's eye-view of the country's entire economic activity. For the purpose of international comparisons the banking and currency statistics in India have to be re-adapted after the standard forms issued formerly by the League of Nations and now by U. N. O.

Although the Reserve Bank has not been able to fulfil completely the millennial expectations, due to the lack of adequate control over all the constituent parts of the credit structure in the country, still a swift and steady progress has been made in improving the banking and currency statistics during its decade's functioning. A separate statistical and research section was created in 1937 mainly for the study of statistics relating to the economic development of the country with particular reference to production, trade, prices and currency. This section is also conducting research from time to time on different problems in which the Reserve Bank is interested, besides collecting various statistics relating to monetary problems and compiling statistical publications of the Reserve Bank.

In a study of statistical material about any aspect of economic life, it has to be remembered that statistical perfection is invariably evanescent. Since the economic life of the nation is always dynamic, fresh problems arise requiring either new material or an alteration in the manner of presentation of the existing information to throw light for evolving a solution. It is an incessent process of furnishing information to unravel fresh problems that present themselves time and again. But it is always possible to come across at any stage of the economic development of the country various lacunae existing in the available material. A swift progress has been made in the banking and currency statistics in India after the advent of the Reserve Bank. In this short period of over a decade, in spite of the

damping effects of war-time restrictions, the Reserve Bank has striven hard to provide adequate information, as far as possible, needed for various statistical studies. A separate research section has been recently organised to study current problems and conduct statistical enquiries. The Reserve Bank is also expanding gradually the staff dealing with statistical information. The post of the Director of Statistics was created in 1945 and the Director is entrusted with the organisation of banking statistics. He has also to conduct statistical investigations besides doing research on various allied problems. With the passing of the Banking Bill which will enable the Reserve Bank to exercise greater control over the credit institutions in the country, it will be possible for the Bank not only to collect information to fill in the existing lacunae in the banking and currency statistics but also to conduct periodical investigations and provide, as far as possible, comprehensive material on various monetary problems that arise time and again with the progress of the economic life of a nation.

APPENDIX I

Official Publications Containing Statistical Information

A. *Weekly Publications*

1. An Account pursuant to the Reserve Bank of India Act, 1934, Issue Department.
2. Statement of the Affairs of the Reserve Bank of India, Banking Department.
3. Statement of the Position of Scheduled Banks.
4. The Indian Trade Journal.

B. *Monthly Publications*

1. Statistical Summary.
2. Monthly Survey of Business Conditions in India.

C. *Annual Publications*

1. Report on Currency and Finance.
2. Statistical Tables relating to Banks in India.
3. Administration Reports of the Mints at Calcutta and Bombay and a Review thereof.
4. Annual Report of the Posts and Telegraphs Department.
5. Statistical Abstract for British India.

APPENDIX II

Periodicaels and Other Publications Having Statistical Material

1. The Journal of the Indian Institue of Bankers.
2. The Commerce.
3. The Indian Finance.
4. The Eastern Economist.
5. The Capital.
6. The Economist (Banking Supplement).
7. Balance-sheets and consolidated statements of some important banks published in different periodicals.
8. Financial reviews, information about Money Markets and Stock Exchanges published in important newspapers.
9. Banking and Currency Supplements containing statistical material and articles on monetary problems.

APPENDIX III

Statistical Material for International Comparisons

Money and Banking was the only annual publication issued by the League of Nations containing the available banking and monetary statistics of different countries. This report is a continuation of the *Memorandum on Commercial Banks* issued in 1931, 1934 and 1935. The first of this series was published by the League of Nations in two volumes, in 1936 with information for the year 1935-'36. The first volume was the Monetary Review and the second dealt with Commercial Banks. Considerable alterations were made frequently in the material published and this report was regularly issued till 1939-'40. Volume I for that year contained abstracts of international monetary statistics whereas volume II on Commercial and Central Banks confined itself to the balance sheets of central banks and to the accounts of commercial banks. A resume of the important monetary and banking developments of the year under review was also included in every section of the second volume. During the war this report was converted into a single biennial publication consisting of two parts. Two such consolidated reports were published for the period 1940-'42 and 1942-'44.

The first part of this report consisted of International Summaries of data on currency, banking and money-rates in nine tables

showing the currency position and movement, principal assets of central banks, recorded central gold reserves, value of world gold production, principal assets, liabilities and cash ratios of commercial banks, indices of bank clearings, money rates and bond yeild, and the value of currencies in terms of the United States cents. The second part was devoted to the balance-sheets, profit and loss accounts of central banks and the aggregate accounts of commercial banks.

The League of Nations published till the outbreak of war a periodical report giving the available statistical details about *Balances of Payments* of different countries. *The World Economic Survey*, an annual publication, included among other things a review of current developments of banking and currency in various countries. This publicttion, just like *Money and Banking*, was issued once in every two years during war time. Two such reports were published by the L. O. N. covering the periods 1940-42 and 1942-44.

The Statistical Year-Book of the League of Nations was another annual publication which gave statistical information about banking and monetary conditions of different countries. This publication was considerably delayed during war years. The year book for 1941-42 was published in 1944 and that for the years 1942-44 in 1945 in a single volume. In view of the many changes in economic conditions in war time a number of alterations were incorporated in the last volume. The section on 'Banking and Currency' contained 10 tables giving details about exchange rates, gold and foreign assets reserves, gold reserves expressed in gold dollars, note circulation, percentage yield on bonds, rates of discount of central banks, money market rates, index numbers of market value of shares, commercial bank deposits and savings bank deposits and certificates. Besides this the League of Nations issued the *Monthly Bulletin of Statistics* which included information about financial conditions of different countries along with statistics of production and stocks, trade, price movements and labour. In the section on Finance, details of banking and monetary conditions were given in 10 tables. They included statistics of exchange rates, value of currencies in terms of U. S. cents, rates in London, price of gold, index numbers of market value of industrial shares, percentage yield of bonds, rates of discount of central banks, money market rates, notes in circulation, gold, silver and foreign assets

reserves, commercial bank deposits, savings deposits and certificates, and public debt. This publication is being continued by the United Nations Organization.

Although the League of Nations attempted and the U. N. O. is now attempting to obtain statistical information from different countries and publish them, the existing material is inadequate and unsuitable for international comparisons. Need has been felt for some time past for a strong international institution vested with the complete powers of comprehensive collection and publication of comparative statistics of all the countries to assist various studies intended for promoting the interests of business community and for furthering the economic progress of the world. Let us hope the International Monetary Fund will prove to be a satisfactory agency for collecting and publishing complete international statistics on banking and currency.

XI
BANKING LEGISLATION IN INDIA

BY

M. L. Tannan

1. *Early Neglect*

Following in the footsteps of the British Government, the Government of India during the British Period adopted the policy of *laissez faire* so far as banking business was concerned. No doubt some stray pieces of legislation such as the Act VI of 1840 and Act V of 1866 regulating the laws relating to bills of exchange and promissory notes were passed. Indian Law Commission also drafted a Bill to codify the law relating to negotiable instruments but owing to the fact that the proposals contained many deviations from the English Law on which it was supposed to be based the Bill had to be redrafted as a result of the many objections raised against it. In 1880 under orders from the Secretary of State for India a new Law Commission considered those proposals and suggested certain additions which were incorporated into the Bill which was put on the statute book as the Negotiable Instruments Act in 1881, a year before the passing of the Bills of Exchange Act in England. But no serious attempt appears to have been made to codify the law' relating to banking as such in India in the last century.

2. *Provisions in the Indian Companies Act, 1913*

A few provisions distinguishing banking companies from other companies are to be found in the Indian Companies Act, 1913. Even the bank failures of 1914-1918 do not appear to have affected the policy of Government in this matter. The Central Banking Inquiry Committee of 1931 considered the question carefully and recommended that the law governing banks should be codified so as to provide the public with a complete code on the subject. Government however instead of accepting this recommendation decided to amend the Indian Companies Act, 1913, and to make certain provisions in it so as to safeguard the interests of the shareholders and depositors of the joint stock banks. The reason for this course, as stated by the then Law Member of the Government of India, was that there was no immediate prospect of legislation dealing solely wifh the subject of banking being undertaken. Amongst the most important matters relating to banks dealt with

in the Indian Companies (Amendment) Act of 1939 were the following:—

1. *Definition of a banking company.* A "Banking Company" means a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft, or order (Sec. 277F).

2. *Prohibition of employment of a managing agent* other than a banking company in the case of banks registered under the Indian Companies Act (Sec. 277H).

3. *Minimum capital requirement.* No banking company to commence business unless shares have been alloted to an amount sufficient to yield a sum of at least Rs. 50,000 as working capital and unless a declaration duly verified by an affidavit signed by the directors and the manager that such a sum has been raised has been filed with the Registrar of Companies (Sec. 277 I).

4. *Transfer of a percentage of the profits to reserve fund.* Every banking company other than a scheduled bank shall out of the declared profits of each year and before any dividend is paid transfer a sum equivalent to not less than 20% of such profits to the reserve fund until the amount of the said fund is equal to its paid up capital (Sec. 277K).

5. *Maintenance of a minimum cash reserve.* Every banking company other than a scheduled bank must maintain by way of cash reserve in cash a sum, equivalent to 1½ p. c. of its time liabilities and 5% of its demand liabilities and to file with the Registrar of Companies before the 10th day of every month a statement so filed on the Friday of each week of the preceding month with particulars of the time and demand liabilities of each such day.

6. *Improvement of the form of the balance sheet* to be submitted by banks. As a result of this banks are required to disclose bad and doubtful debts, if any.

7. *Not to create any charge upon unpaid capital.* A banking company is prohibited to create any charge upon its unpaid capital; and if created, it will be deemed as invalid.

8. *Banks to have no non-banking subsidiary companies* except subsidiary companies of their own formed for the purpose of under-

taking and executing trusts, undertaking the administration of estates as executors, trustees or otherwise and such other purposes set forth in Sec. 277F of the Indian Companies (Amendment) Act, 1936, as are incidental to the business of accepting deposits of money on current account or otherwise.

9. *Stay of actions* and proceedings against a banking company.

1 The Court may on the application of a banking company which is temporarily unable to meet its obligation make an order staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper and may from time to time extend the period.

2. No such application shall be maintainable unless accompanied by report of the Registrar of Joint Stock Companies, provided, however, the Court may, for sufficient reasons, grant interim relief. even if the application is not accompanied by such report.

3. The Registrar shall for the purposes of his report be entitled at the cost of the company to investigate the financial condition of the company and for such purpose to have the books and documents of the company examined by an accountant holding a certificate issued under section 144 (Sec. 277N).

3. *The Reserve Bank Proposals*, 1939

The Reserve Bank of India took up the question of the amendment of some of the provisions in the Indian Companies Act relating to banks and submitted its proposals to Government in 1939 with a view to secure a network of properly managed and financially sound banking institutions which would enable the Bank to co-ordinate the credit structure of the country and to more fully utilize the means of extending credit provided for under the Reserve Bank Act. The broad features of these proposals were as follows :—

1. To have a simpler definition of banking than the one given in Sec. 277F of the Indian Companies Act and to remedy the anomaly arising from Sec. 277G (1) of the Act under which, institutions incorporated prior to the 15th January, 1937, might call themselves banks and yet refuse to comply with the statutory provisions relating to banking companies.

2. To ensure the maintenance by banking companies of a minimum amount of capital and also of certain proportions between their authorised, subscribed and paid up capital.

3. To impose moderate restrictions on bank investments and also to protect British India depositors in the case of banks incorporated outside British India.

4. To provide for a simplified procedure for the liquidation of banking companies.

The Government of India, owing to their pre-occupation with the War, were not prepared to take up the question of a comprehensive legislation but took interim measures from time to time provided they embodied a minimum of legislation and these were embodied in the form of amendments to the existing provisions relating to banking companies.

The first of such amendment relates to the definition of a banking company by the insertion of a proviso to See. 277F to the effect that any company which uses the world "bank", "banker" or "banking" as a part of its name shall be deemed to be a banking company irrespective of whether the business of accepting money on current account or otherwise subject to withdrawal by cheque, draft or order is its principal business or not. This amendment came into force on the 1st November, 1943. In March, 1944, further amendments to sections 277H & 277G were made with a view to remove some undesirable features noticed in the capital structure and the remuneration of persons employed by banks. Accordingly it was provided that even in the case of banking companies incorporated before the 15th January, 1937, that (1) the subscribed capital should not be less than half of the authorised capital and that the paid up capital should not be less than half of the subscribed ; (2) the capital should consist of ordinary shares only or ordinary and preference shares as may have been issued before 1st July, 1944 ; and (3) that the voting rights of all shareholders should be strictly in proportion to the contribution made by the shareholder to the paid up capital of the company. It was also laid down that no person was to be employed on the basis of commission or a share in the profits of a banking company nor for a period exceeding five years at a time.

4. *The Banking Bill, 1945*

A little later Government finding that the question of the banking legislation required urgent attention had a Banking Bill drafted which was introduced in the Legislative Assembly on the

16th Novembery, 1944. The Bill aimed at a more detailed type of control on banks and it took all rules applying only to banks out of the Indian Companies Act and put them together. It did not form quite a complete code but was to be read with the commercial code of the country which regulates the corporate existence of joint-stock banking companies.

Space at our disposal does not permit us to examine in detail the provisions of the said Bill which, if passed, was proposed to be called "The Banking Companies Act, 1945," but attention of the reader is invited particularly to its following features:—

1. It was for the first time that a provision for the licensing of banking companies incorporated outside British India was made. Sec. 17 of the Bill provided for the licensing of foreign banks intending to open branches in India on the basis of reciprocal treatment of Indian nationals and companies in the foreign countries concerned. This provision appears to be based on the Japanese banking law.

2. Section 2 of the Bill prohibited the granting of loans or advances on the security of a bank's own shares. Such restrictions are to be found in the case of banks in Canada, Chile, Finland, Poland and Rumania.

3. Raising the minimum capital and reserve required for a bank from Rs. 50,000 to Rs. 1 lakh and allowing a bank to open a place of business outside the province in which it has its principal place of business only when its paid-up capital and reserve fund are not less than Rs. 20 lakhs. It was also proposed that no bank whose paid-up capital and reserve fund are less than Rs. 5 lakhs should open a branch in Bombay or Calcutta and that a bank wanting to open a branch in any city other than Bombay or Calcutta should have an additional capital and reserve of Rs. 2 lakhs for every town with a population of 1 lakh or more and Rs. 10,000 in respect of each branch opened elsewhere. It is to be understood that a bank with a paid-up capital and reserve Rs. 20 lakhs or more could open a branch anywhere in India and could have any number of branches it liked. Provisions classifying banks for capital required according to the importance of locality or its population are to be found in the United States of America, Italy, Japan, etc., and are generally necessary for the carrying on of the banking business.

4. Sec. 6 enumerated the forms of business which a banking company can undertake besides the business of banking. This section was meant to safeguard the interests of the depositors of banks against the locking up of their funds in the shares of industrial concerns which cannot be easily liquidated in times of emergency. The mixed type of banking which existed in countries such as Germany, Italy and Belgium was to be discouraged and permanent and semi-permanent participation in industry was to be left to institutions other than commercial banks.

5. Sections 8 and 9 which were not to be found in the draft proposals of Reserve Bank of India prohibted banks from undertaking directly or indirectly trading activities and undertaking trading risks and to dispose of non-banking assets within the prescribed time limit.

6. Sec. 11 (2) provided for the extension of control over banks incorporated elsewhere than in British India or the United Kingdom by making it obligatory on these banks to deposit with the Reserve Bank of India an amount not less than the minimum amount of paid-up capital and reserve required either in cash or unencumbered approved securities. This would give some protection to the depositors in India of foreign banks that may have branches in British India.

7. Sec. 14 which established a liquidity ratio of certain assets to time and demand liabilities, gave powers to the Reserve Bank regarding their variation and occasional relaxation so as to enable the said bank to have the necessary control over the credit situation of the country in times of emergency.

8. Section 20 prescribed monthly returns to the Reserve Bank of India and information regarding advances and investments to be submitted by every banking company. This would enable the Bank to have a full picture of the banking situation.

9. Sec. 28 provided for inspection in certain circumstances of a bank's books by the Reserve Bank of India at the instance of Central Government. This was a very desirable provision both in the interests of the depositors as well as the banks which carry on their business on sound lines.

In conclusion, it is bound to be admitted that although there may be honest differences of opinion about some of the provisions of the

said Bill, the proposed legislation was meant to put the banking development in the country on sound footing.

5. *Banking Companies Bill, 1946*

The Banking Companies Bill of 1945, however, lapsed owing to the dissolution of the Legislature. But on 15th March 1946, Sir Archibald Rowlands, the then Finance Member, re-introduced the Bill, which was revised in the light of the public opinion. On 11th April, 1946, a motion was adopted to refer the Bill to a Select Committee of the Legislative Assembly. The main features of the Bill were as follows :

(i) A simple definition of banking was adopted so that the legislation may be limited to those institutions in which funds are deposited and the safety and ready withdrawability thereof may be ensured.

(ii) Minimum capital standards were fixed.

(iii) The carrying of trade was prohibited so that non-banking risks may be eliminated.

(iv) Banks incorporated or registered outside British India were also included in the scope of legislation.

(v) A comprehensive system of licensing the banks was introduced.

(vi) Provision was made for expeditious procedure for liquidation.

(vii) Reserve Bank of India was authorised to inspect the books and accounts of a bank whenever it thought it necessary.

(viii) Central Government was empowered to take against those banks which conducted their affairs in a manner detrimental to the interests of the depositors.

(ix) A special form of balance sheet was prescribed and Reserve Bank was empowered to call for periodical returns.

The Banking Companies Bill of 1945 was revised and improved upon in several ways. Clause 18 was revised and provided that the Bill will apply to all banks with the exception that scheduled banks other than those whose country of origin discriminates in any way against British India banks are exempted. A new clause

45 was added whereby the Reserve Bank was authorised to include or exclude a bank from the second schedule according to revised standards. Amalgamations without prior permission were prohibited. Banks' interest in subsidiary companies was subjected to stricter provisions. Greater powers were given to the Reserve Bank to obtain statistics.

Three Banking Measures of 1946. The Bill was not presented to the Central Legislature in 1946 and not even in the February, 1947, session of the Assembly. This delay perhaps was responsible for certain banking measures enacted during the year 1946.

The first of such measures was the *Banking Companies Inspection Ordinance*, 1946, which was issued on 12th January, 1946. This Ordinance empowered the Government of India to direct the Reserve Bank to inspect the affairs of any banking company, and if the inspection report showed that it was conducting business in a manner detrimental to the interests of its depositors, it might prohibit the Bank from taking further deposits and direct its exclusion from the Second Schedule. Such an action has already been taken against a number of banks like the International Bank of India, Ltd., the Aryan Bank, Ltd., etc. It is hoped that this Ordinance will serve to check the malpractices of weak and newly started small banks.

The second measure was the Bearer Promissory Notes (Prohibition of Issue) Ordinance, 1946, which was promulgated on 18th May, 1946. It prohibited Indian banks from issuing promissory notes payable to bearer which passed from hand to hand and which were regarded as equivalent to Bank Notes. Under section 31 of the Reserve Bank Act, the Reserve Bank has the monopoly rights of issuing Bank notes and this practice of banks appeared to come into conflict with the provisions of this section. This Ordinance was replaced on 11th November, 1946, by an amendment of the Reserve Bank Act whereby the old section 31 of that Act has been made section 31 (i) and a new section 31 (ii) has been added which runs as follows :—

Notwithstanding anything contained in the Negotiable Instruments Act, 1881, no person in British India other than the Bank, or, as expressly authorised by this Act, the Central Government shall make or cause any promissory note expressed to be payable to the bearer of the instrument.

The third measure was passed by the Legislative Assembly on 14th November, 1946, in the shape of the Banking Companies (Restriction of Branches) Act. According to this, no bank can open any new branch or change the location of an existing branch without the previous written permission of the Reserve Bank. The Reserve Bank may give or refuse such permission in the light of the study of the applicants' history, management, financial strength, prospects of profit, public interest, etc.

6. *Banking Companies Bill*, 1948

The report of the Select Committee on the Banking Companies Bill, 1946, was presented to the Central Legislative Assembly on 17th Feberuary, 1947. But it could not be taken up because the Indian Independence Act, 1947, which was in the meanwhile passed, necessitated many changes in it. Consequently the Government decided to make a fresh Bill incorporating all the changes and refer it to a Select Committee. The old Bill was withdrawn from the Constituent Assembly (Legislative) on 30th January, 1948, and a new Banking Companies Bill, 1948, was introduced on 22nd March, 1948. The main features of the new Bill are discussed below:

(i) A comprehensive definition of 'banking' has been adopted so that all institutions which receive deposits, repayable on demand or otherwise, for lending or investment, may be brought within the scope of the legislation.

(ii) Non-banking companies have been prohibited from accepting deposits payable on demand.

(iii) The carrying on of trade has been prohibited so that non-banking risks may be eliminated.

(iv) Minimum capital standards have been prescribed.

(v) Payment of dividends has been limited.

(vi) Banks incorporated or registered outside the provinces of India have been included in the scope of legislation.

(vii) A comprehensive system of licensing the banks and their branches has been introduced.

(viii) Special form of balance sheet has been prescribed and the Reserve Bank has been empowered to call for periodical returns.

(ix) Reserve Bank can inspect the books of accounts of a bank when it thinks necessary.

(x) Central Government has been empowered to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors.

(xi) Provision has been made for bringing the Reserve Bank into closer touch with banking companies.

(xii) Provision has been made for an expeditious procedure for liquidation.

(xiii) The Imperial Bank of India has been brought within the purview of some of the provisions of the Bill.

(xiv) The powers of the Reserve Bank have been widened so that it may be able to come to the rescue of banking companies in times of emergency.

(xv) Provision has also been made to extend the Act to acceding States.

Amendment af Sec. 18 (3) of the Reserve Bank of India Act. The partition of the country created conditions which began to prove very critical for certain banks; but the Reserve Bank could not come to their aid under existing Act. Hence mainly with a view to meet such cases and pending the enactment of the Banking Companies Bill, an Ordinance was promulgated on 20th September, 1947, amending Sec. 18 (3) of the Reserve Bank of India Act. This empowered the Reserve Bank to grant advances under emergency to all banks scheduled and non-scheduled, against such securities as it may consider sufficient. The Reserve Bank, however, had no occasion to grant advances under the Ordinance. Hence it was allowed to expire on 20th March, 1948.

Banking Companies (East Punjab and Delhi) Ordinance, 1947. As a result of partition, many of the banks, especially middle-sized and small banks, which had most of their assets in the West Punjab, migrated to East Punjab or Delhi and with them came their liabilities but not their assets. They experienced difficulty in making immediate arrangements for meeting their liabilities. Their records were also in many cases left in West Bengal, which was another serious difficulty. To assist such banks, to avoid distress to depositors and a disaster to the banking system itself, the Government of India promulgated a Banking Companies Ordinance on 27th September, 1947. This empowered the Government to make an order

staying for a period of three months the commencement or continuance of all actions and proceedings against a banking company which applied for it and whose registered office was in East Punjab or Delhi. It was further provided that during the period of moratorium, the bank concerned was not to make payments to its depositors in any month in excess of 1% of the total of the current and deposit accounts at each branch in India or Rs. 250 whichever was less. It was also required to make similar payments to depositors who could satisfy the bank regarding their deposits in branches outside India. But the bank could not accept deposits nor dispose of any of its assets except for payments to the extent permitted under the Ordinance; and the bank's normal running expenses. The Central Government was, further empowered to advance sums to such a bank to effect these payments to depositors. The scope of this Ordinance was later amended by an amendment on 13th December, 1947, providing for payment up to 30% of the amount of the draft or Rs. 750, whichever is less. This Ordinance lapsed on 27th March, 1948.

7. *Conclusion*

The Banking Companies Bill of 1948 is the outcome of long and detailed consideration by several expert committees and also competent public opinion. As is clear from some of the provisions of the Bill mentioned above, it seeks to meet some of our most urgent banking needs; and it will surely contribute to the strengthing of the Indian banking system. The passing of this Bill, and the nationalization of the Reserve Bank and the Imperial Bank, will open a new leaf in the history of the Indian Banking; and we are sure our banking structure will become stable and grow so as to change beyond recognition in non-too-distant future.

XII

THE NATIONALIZATION OF BANKS IN INDIA

BY

N. G. Ranga

The present-day banking system in our country suffers from a number of serious defects and shortcomings which have been placing hurdles time and again in the economic development of the country. Academic economists, practical bankers and politicians have suggested the ways and means of toning up, improving and expanding our banking industry; and there is no doubt that by putting them into practice much can be achieved. But the nationalisation of the banking industry as a whole is an approach which is pregnant with great possibilities; and we trust that it will make the solution of our problems much easier.

Nationalisation of Reserve Bank of India

Let us begin with the apex banking institution of this country, the Reserve Bank of India. It possesses considerable powers; and the recent Indian Banking Companies Bill contemplates to place more power in its hands. But who is this Reserve Bank of India? It is said to be an institution. It is not an individual, it is true. But who had created it? The Government of England. And for whose purposes? Was it for the purposes of India? If it was for the purposes of India, then why was it not made a hundred per cent. State Bank? Why was it made a shareholders' bank? Why did the Government bring in a number of gentlemen from various cities of our own country and put them there and gave them the gilded names of Directors and on the top of them placed their own officers as Governor and Deputy Governor? Why all this *tamasha*? Make it a State Bank and we will know where we are and we will control it better. In the past, the Government came to us and told us that it was a shareholders' bank; it was an Indian organization and the Legislature could not possibly be expected to have day-to-day control over it. It could not have a scrutiny over its activities and could not put any questions and Government could not be expected to be held responsible for all its activities. Why was it be so? The Government wanted to protect the vested

interests of European industrialists in this country, and these had a big hand in the governance of the Reserve Bank of India either directly or indirectly.

It is, of course, not meant that the Government in the past did not exercise any sort of control over the Reserve Bank of India. They controlled the Reserve Bank to a very great extent. Indeed, although lhe Governor was supposed to be an elected person, it was the Government of India which decided really who was to be the Governor. The Australian Governor of the Reserve Bank, Sir Osborne Smith,* resigned and went away. But who forced him to resign? Even if he had been a Britisher and dared to disagree with the Finance Member, he would have been asked to resign. A Britisher was in the past allowed to serve in this country in any one of the Government offices only so long as he served the British Imperialist interests. During the World War II the Reserve Bank served the Government and helped the Government to inflict terrible inflation upon our country It also served the Government to create a sort of black market on behalf of South Africa and other countries for selling gold and silver and giving over all the profits to them, not even giving to the public information whether on these profits income-tax was being paid to the Government or not. The Finance Member did not furnish us the information about the Reserve Bank. He used to tell us that it was an autonomous organization. We surely do not want it to be so autonomous that the Indian Legislature will have no conttol over it and the Government will be so irresponsible in regard to its activities as not to take the elected representatives of the people into its confidence in regard to its activities.

What has been the result of this present constitution of the Reserve Bank? It has failed, and failed miserably, in discharging its functions. The Reserve Bank was charged with the task of helping the rural credit of this country. There was a special provision made in the Act to this effect. But the Bank did not do anything more than publishing some reports and supplying them to some of the members of the Legislature! Is that all that was expected of ths Reserve Bank according to the Central Banking Enquiry Committee Report? Why has the Bank neglected the development of agriculture? Did the Reserve Bank do anything to promote our industries? We also want the Reserve Bank to take

more active part in helping our scheduled banks in their legitimate task of advancing credit to our various industries, in stimulating a policy of growth of new industries and providing them with adequate credit so that these industries can develop in all directions. It has done nothing to provide credit for the development of cottage industries.

We, therefore, welcome the decision of the Government of India to nationalise our apex banking institution. It will be recalled that on 18th February, 1947, a non-official resolution was tabled in the Central Legislative Assembly proposing that the Reserve Bank of India should be nationalized. The then Finance Member thereupon announced in his budget speech of 28th February, 1947, that the Government had decided to nationalise the Reserve Bank. This decision could not, however, be given effect at that time; and after partition of the country, the Finance Minister declared on 4th February, 1948, that the Government proposed to take steps to nationalise the Reserve Bank as soon as possible after 30th September, 1948, when the Bank would cease to be a common banker for India and Pakistan. The intention of the Government was to acquire the shares of the Reserve Bank at average market value for the period March, 1947 to February. 1948 (opening monthly quotations) and to issue instead 3 per cent long-dated Government stock. The question was, however, again postponed for the time being; but the Government of India have now declared that on January 1, 1948, the Reserve Bank will be completely nationalized. This is to be greatly welcomed and is sure to be followed by useful results for Indian Banking system and the entire Indian economy.

Nationalization of the Imperial Bank of India

But there is need of carrying the policy of the nationalization of banks further. The Imperial Bank of India, replaced from the apex by the Reserve Bank of India long ago, still occupies an unparalleled position in the Indian Banking System. The working of the Imperial Bank of India has left much to be desired in the past; and there is urgent need of its nationalization. It is, again, a matter of gratification that the Government of India have accepted the policy of its nationalization. But its nationalization will require information which will take time to be gathered. The question of foreign branches of the bank, the compensation to be given to shareholders, the base-value of shares to be used for exchange purposes, and so forth, are being considered. We hope these preliminaries will soon

be completed and the Imperial Bank of India will also soon be nationalized so that it may embark upon various vital banking businesses which require expansion and encouragment.

A Case for State Banks

The policy of nationalization, which is to begin with the Reserve Bank of India and the Imperial Bank of India, should be carried to its logical conclusion; and the Government should set up its own banks.

A strong case for the Government banks can be made on the experience of the savings banks started by the post offices in this country. They can considerably draw upon this experience. The post office saving bank pays quite a reasonable rate of interest on those deposits. In fact, at one time these deposits had swollen to such proportions that Sir James Grigg found it necessary to reduce the rate of interest that was being paid on them The post office savings bank is trusted by the people of the country. We know that it is officially managed, no money has been lost till now, there has not been any sort of complaint that any of the savings bank branches has failed, there has not been at any time any serious run on the post office savings bank except during the short period when the fate of England was in the balance. Even that run was not very much. When the Government of India have such long experience of savings bank businesses, what is it that prevents them from having their own banking system?

Short of complete nationalization of the banking industry, a policy of active participation by the Government in the banking business will bring satisfactory results in its train. If the Government of India and the provinces enter the business of banking and start their own banks in competition, if necessary, with the existing banks and provide additional facilities for the people, it will pay them. It would certainly help the industries; it would certainly be able to draw funds which are at present shy from those people who are unwilling to trust their small savings to banks. If Government are able to start their own banks and open an adequate number of branches, they will be doing a good thing. Many of our people who wish to save and who are saving will only be too glad to put their monies in such banks, and when they get used to the banking habit it is possible that the other banks will also be prosperous.

But we should not be satisfied with this position. We want a complete nationalization of the banking industry in this country. The country is now thinking of economic planning and of economic, industrial and agricultural development on a vast scale. Planning will require enormous finances. Wherefrom are you going to get that? You want to induce our people to save more and place it at your disposal. But they want to be given a much greater inducement than the ordinary inducement that the money will be safe as is offered by the Government Bill and that a small interest will be paid thereon. They want to be told that *their monies will be put to the best possible use, and through the best possible institution and through the manipulation of their money no private interest will make any profits*, and their monies will be allocated as between different industries, as between different industrial concerns which will serve the national cause also. This can be done through State banks.

Our Government may say that every State has started with police work and it is only afterwards that it has matured into developmental activities and similarly that they are also going into it. Then let not the Government talk of post-war development. If you want post-war development, you must induce our people to give up their hoarding habits. Those of them who can save and have got spare funds at their disposal are hoarding their savings. And why do they hoard? They do it because they have no faith in banks, because they are managed by private interests and for private profits—big profits—and because these banks cannot be expected to behave. Therefore, the nationalization of banks is absolutely inevitable.. And what is more, if you do not do it you are going to endanger your post-war economy. And for this reason, what your irrigation canals are to our irrigated lands, your savings are for the industrial development of our country. Without these irrigation canals you cannot draw the savings of our people to the industries. Banks can only serve as canals. Is anyone coming forward to suggest that irrigation canals shall be owned by these various private industrialists? Yes, there was a time in England when these canals were owned by private merchants, industrialists and capitalists. But they came to realise that that system was really very bad, too costly and too cumbersome and too reactionary; so they gave it up. There is nobody in this country who suggests that our irrigation system as a whole should be handed over to any sort of profitmaking

company. There is no one who at this time of the day is prepared to say that our railways should be handed over to the railway companies. There was one gentleman by name Wedgwood who came down to this country; he investigated our railways or pretended to do so and made a report in which he suggested that our railways should be handed over to a semi-autonomous organization. No one in this country was prepared to look at it: the Assembly simply turned down the proposals. Such is the position in regard to railways. Certainly banking occupies a much greater key position than railways. And why do you want this kev service to be monopolised by the gentlemen who are interested only in their profits and in nothing else? We are told that the banks are semi-public interests. If so, how can you trust these semi-public interests to the vagaries of the profit-earning gentlemen? Supposing there is any sort of danger in your not being able to make any profits at all; will these gentlemen carry on any banking? There is indeed a chance for them to make huge profits in banking. Will they possibly be as ready to take up any risky business? They have not shown themselves to be so very responsible minded nor have they displayed any such appreciation of national interests in regard to so many important industries.

As is well-known, an important function of a bank is to manufacture and regulate the distribution of credit. If any particular bank has ten crores of rupees it does business worth fifty crores or sometimes a hundred crores. In that way these people create credit and can provide credit also to the country. The old quantity theory of money may have been exploded to some extent, but neverthelss money can be provided not so much in terms of more currency coins and currency notes as in terms of cheques and drafts by banks. And why do you allow these private individuals to gain control over this huge credit machinery? It is through this credit machinery that the Government can finance any peace-time or war-time economy. And if our economic development programmes are to be executed, then it is most essential that our national Government must gain complete control of such a key service as the provision and regulation of credit.

XIII

THE ORGANIZATION OF A BILL MARKET IN INDIA

BY

Pares Das Gupta

There are certain pitiable drawbacks inherent in the structure of our national economy. To ensure fullest possible economic development, these drawbacks must be removed and the entire economy of the country must be placed on a mobile equilibrium. The present paper, however, does not offer adequate scope for a detailed discussion of the problem in its manifold aspects and the author proposes to confine himself to the question of industrial finance. As is well-known, Indian establishments are financially much weaker than their foreign rivals, and in most cases this renders it impossible for them to properly utilise the modern techniques of mass-production. This evidently diminishes their competitive strength and affects their efficiency. At the present time and in near future, the problem of finance has become all the more serious. During the war science wrought miracles and industrial techniques have improved beyond recognition. The last ten years have far outspeeded the progress of a century. The productive equipments of the thirties have already become obsolete and even on the organizational aspect achievements in Europe and America have been no less astonishing. If in such a world, rich with scientific inventions, India aspires to take her rightful place, her existing industries must be re-hauled, re-planned and re-equipped and the establishments yet to be born must be conceived on the model of Euro-American concerns.

This will necessarily require colossal capital investments and any such gigantic planning can be worked and sustained only on a sound basis of healthy cooperation between industrial and financial houses in the country. Thus, the pre-requisite of economic planning is the large-scale-canalisation of the country's capital resources. In the past, Indian financial houses stuck themselves to the principles of British banking irrespective of the conditions and requirements of the country. This has often betrayed a lack of active coopera- tion between the banking institutions on the one hand and the trade

and industry on the other. In this respect the studied neutrality of the Government and the inactivity of the Reserve Bank of India have been no little responsible.

Difficulties in obtaining easy and regular financial accommodation as needed from time to time have put a serious brake on the indigenous industries. Even the established major industries in the country have not been spared and the medium-sized concerns, that constitute the bulk of our existing establishments, have been suffering awkward troubles, too often in their day to day transactions. The real situation may well be appreciated from the fact that as late as 1930, loans and cash credit offered to 64 cotton mills in Bombay amounted to 2.26 crores or 9 per cent. of their total current financial requirements estimated at 24.83 crores. Conditions at Ahmedabad were reported still to be unsatisfactory. Out of Rs. 10 crores required on current account by the 56 Ahmedabad mills only 42 lakhs or 4 per cent. could be obtained from the banking houses. Such a state of affairs hardly bids well for industrial development of the country.

Of course, it is not argued here that the commercial banks should go out of their way to provide block capital to industries and thereby jeopardise their own safety. The function of commercial banking is now well understood and the need for industrial banks and mortgaging institutions has long been mooted out. The unhappy experiences of the past may be recalled and the failure of certain big organizations, particularly the Tata Industrial Bank Ltd., may also be pointed out. But still one may reasonably plead that our banking institutions should be more accommodating to the requirements of our industries. In this respect a lesson should be taken from the recent changes in the British banking system that has definitely been knocked out of the shell of puritanism that it had retained and preserved for centuries.

Industrial Finance

Financial requirements of trade and industry may broadly be classified under two categories, (a) block capital, and (b) working capital. Block capital which should be raised by the sale of shares of a company or by issuing debentures is not proposed to be discussed here, as it would be more relevant to the central theme of this paper to concentrate on the problem of working capital. Of course, it needs be appreciated that in a manufacturing concern a portion of the working capital necessarily partakes of the nature of block capital inasmuch as a period of three months to one year may lapse

before it can be expected to return. In certain industries for instance, raw materials are required to be purchased in bulk and the processing needs a considerable period of time. In such cases if the funds have not been already provided for either from the share capital or debentures it may be had from banks in the form of advances or loans through the usual procedure of stock hypothecation.

Besides this, a substantial proportion of the revolving capital is normally obtained by discounting bills, and, in fact, all classes of banks undertake this business according to their capacity and discretion. Import or export bills of approved parties are discounted by the exchange banks. Of course, no clear line of distinction can be made between the nature of business transacted by the exchange banks on the one hand and the commercial banks on the other. As is widely known, the foreign exchange banks working in India not unoften undertake to finance even a part of the inland trade conducted by the European firms. But the Indian section of the trade and industry receives little accommodation from these banks and for their short-term finance they have exclusively to depend on Indian banking houses. Here again, it must be admitted that the Indian banking houses have not been as yet, able to meet squarely the requirements of the indigenous trade and industry. In the absence of an organised Bill Market the trade is seriously handicapped. Reputed firms with their long established connections with top-rank banking houses are readily accommodated, but in the case of smaller concerns and those of recent growth it is not an infrequent happening that they have to knock from door to door, and when arrangements are at last effected the rate of interest charged is highly discriminatory. The shortcomings of the existing state of affairs and the extra cautiousness of the bank authorities are evidenced by their reluctance, until very recently, to discount bills drawn against the supply of goods to Government department; municipalities railways and other public and semi-public institutions. Even in the initial stages of war supply, the contractors had to encounter great difficulties in effecting bill discounting arrangements with their bankers. Fortunately, however, towards the end of 1943, intensification of economic war efforts by the Government elicited cooperation from a section of the Indian banks, particularly Bengali Banks. Still then, discounting of bills constituted a very minor percentage of the total investment of the Indian banks. Thus the average amount of bills discounted by the scheduled banks had

SCHEDULED BANKS *(In Lakhs Of Rupees)*

Bills discounted in India and Burma. (Annual Averages)

Year.				
1935-36	...	...	...	359
1936-37	...	...	...	473
1937-38	...	...	...	626
1938-39	...	...	...	484
1939-40	...	...	...	525
1940-41	...	...	...	384
1941-42	...	...	...	493
1942-43	...	...	...	218
1943-44	...	...	...	559
1944-45	...	...	...	1,116

declined to Rs. 2,18 lakhs only in 1942-43 as against Rs. 5,25 lakhs in 1939-40. In 1943-44 there was appreciable recovery and in the following year the money value of the average total of bills discounted was remarkably high at Rs. 11,16 lakhs. This increase definitely implies a more liberal policy adopted by the banks and better facilities offered for discounting of bills; nonetheless, the pronounced effects of inflationary marking up of general values, tended to bolster up the nominal (rupee) prices of bills to a very considerable extent. During the same period the amount of advances made by the scheduled banks also increased substantially but the precentage of total advances and bills discounted to total liabilities recorded a fall.

SCHEDULED BANKS (In Lakhs Of Rupees)

Year	No. of Schedul-ed Banks	Total demand & Time Liabilities (a)	Advance (b)	Bills discoun-ted (c)	Total Advances & Bills discounted (d)	% of (d) to (a)
1935-36 ...	50	22,056	8,770	356	9,126	41.38
1936-37 ...	50	22,990	9,511	470	9,981	43.41
1937-38 ...	54	24,181	11,343	628	11,971	49.51
1938-39 ...	55	23,783	11,585	486	12,071	50.75
1939-40 ...	59	24,568	12,589	525	13,114	53.38
1940-41 ...	63	26,884	12,213	384	12,597	46.86
1941-42 ...	59	31,896	12,020	493	12,513	39.23
1942-43 ...	61	41,049	9,568	218	9,786	23.83
1943-44 ...	75	59,941	15,614	559	16,173	26.98
1944-45 ...	84	77,892	22,422	1,116	23,538	30.22

The actual trends of events are well summarised in the following statement quoted from Report on Currency and Finance (1944-45), issued by the Reserve Bank of India. It is observed that the "advances and discounts showed converse movements to those of each and balances until September, 1942, super-posed over a falling general trend of the former and a rising tendency in the latter. By then the decline in advances and discounts was definitely over and a continuous upward trend started, which was arrested or slightly reversed only for a brief period. Altogether advances and bills discounted rose from Rs. 80.12 crores in September, 1942. to the considerable level of Rs. 287.72 crores in March, 1945, a rise of 259 per cent, their percentage to total demand and time liabilities increasing from 19.6 to 34.9. The average percentage for the year, however, was 30.2 in 1945 as against 27 in 1943-44 and 23.8 in 1942-43,

and was still far below the pre-war percentage of 50.8 or the percentages during the early war year." Recounting further that the inflationary advances of values and prices accounted on average for 150 to 200 per cent. increase in the money value of the trade bills (in certain sections the increase was over 400 per cent.), it may be reasonably inferred that even during the war-time boom the commercial banks offered no better facilities for discounting of trade and other bills. This betrays a vital lacuna in the structure of our industrial economy. Of course, it would be unfair to lay the blame entirely on the banking authorities. The absence of an organised discount-market where bills of different categories can be readily disposed and exchanged, is the principal drawback. But to establish such institutions in Calcutta, Bombay and other important business centres, certain conditions need be fulfilled. These will be discussed at a later stage. Still, however, one can hardly resist feeling that joint efforts of the leading Indian banks, supported by liberal re-discounting facilities improvised by the Reserve Bank could have substantially improved the situation.

Classification of Bills

Bills that are usually accepted for discounting or rediscounting in the money markets of the advanced countries take varied forms and it would be of little advantage to enter into their details. In India there is no Bill Market approaching the discounting market of London and in the matter of discounting bills the attitude of the Indian banks still betrays a sense of cautious rigidity incompatible to the expansive demands of a progressive economy. This being the actual condition in the country, we should better confine ourselves to the common types of bills that will be required to be disposed of in the proposed Bill Market. Broadly speaking, such bills may be classified as follows:

(*a*) *Treasury Bills*

In every modern State it is the common practice to tap the money market for short-term accommodation by issuing Treasury Bills. These are generally issued for a currency of three to six months and convey the security of the Government and as such "they constitute a particularly ideal form of investment for the surplus funds of banks" that may not be considered otherwise loanable for any longer period. Issue of Treasury Bills now form a part of the regular functions of the Government, intended to enable the central

bank to participate in open market operations and thereby to control the money market of the country.

In India these bills are issued by public tender every week at the counter of the Reserve Bank. They are generally tendered for b a few big banks and the common investing public take little interest. Thus the Imperial Bank alone absorbs about 40 to 45 per cent. of the total issues and another 50 per cent. is taken over by the other banking houses. The balance of 5 to 10 per cent. is covered by the contribution of private individuals and non-banking instiutions. This restriction of the Treasury Bill market is a serious handicap. On the one hand, it deprives the Reserve Bank of a valuable means to control the money market and, on the other, the absence of any wide popular interest in these bills not unoften renders it impossible for the Government to obtain accommodation at convenient rates. Thus it is rightly observed that "one serious defect of the Treasury Bill Market in India is the absence of any material support outside the banks. In London a considerable amount of extra money market funds seeks investment in Treasury Bills. This assists the Government in obtaining better rates. In India the absence of any material outside support makes the Government depend principally upon a few banks for the financing of Treasury Bills, and sometimes the Reserve Bank has to intervene by purchasing bills on its own account to ensure a successful placing of Treasury Bills."[1] This is a condition least covetable to any progressive Government having to incur large budgetary expenditure.

In substance, the institution of an organised Bill Market will offer Government wide monetary support and the Treasury Bills will come to be regarded as an important instrument of the money market, almost equivalent to cash. Thus, they will obtain easy currency and shall be freely discountable. It may be noted here that at present, the discounting of Treasury Bills is looked upon with disfavour in the Indian banking quarters and naturally, therefore, their holdings of these bills constitute a very minor percentage of their investments, the Imperial Bank of India and the big exchange banks mainly dealing in them. This deprives Government of an important financial support, and to remove this vital deficiency, the institution of an organised Bill Market would be in Government's own interests.

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[1] Bimal C. Ghose, *A Study of the Indian Money Market.*

(b) *Foreign Trade Bills*

This class of bills forms the usual instrument of foreign trade, and may be sub-classed as Export Bills and Import Bills. The Export Bill is drawn by the Indian exporter upon his overseas buyer and the Import Bill indicates a revese course of transaction. The exchange banks operating in India, which are almost cent per cent foreign concerns, finance these bills and thus, in a sense, control the country's entire foreign trade. This is a condition far from satisfactory. Apart from the complaint that these exchange banks in the course of their dealing with the trade unfairly discriminate in favour of non-Indian firms, there are other specific disadvantages directly arising out of the existing conditions. Thus the foreign trade bills, both Export and Import Bills, are drawn in sterling so that these may be transferred by the exchange banks to their London offices and rediscounted there in the open market, instead of being kept in the portfolio till maturity. This is in direct contradiction to the practice obtaining in other countries where foreign bills are usually drawn in the currency of the country of destination. The net effect of this is to render the Indian market subservient to the London money market to a considerable extent, and this too quite unnecessarily. The institution of a Bill Market will help removing this incongruity and the Indian banks will have a greater opportunity of participating in the country's external trade.

(c) *Indian Trade Bills*

These are of the most common type and may be distinguished as bills supplementary to foreign trade bills and those others arising in connection with purely inland trade. The first category of bills are again financed by the exchange banks and the contributions of the Indian banks are yet anything but significant. The latter type, covering genuine inland trade, are carried in the portfolio of indigenous banks. But here too the statistical data available indicate the unresponsive attitude of the Indian banks and their over-cautiousness.

From the Tabe given on the next page, it will be seen that out of a total fund of Rs. 779 crores at command of the scheduled banks, only Rs. 11 crores were available for financing bills and of this again not more than Rs. 7 to 8 crores could have been available for the discounting of genuine inland trade bills. Thus the proportion works out to about one per cent. of the total

for the U. S. A. and India, if the vexed problem of India's sterling balances and her need for hard currency is to be solved. The U. S. A. shouldered the greater portion of the burdens of the recent international war, and India had suffered serious disfigurement in the economic sphere as a result of the United Nations basing their war effort, in the fight against Japan, on Indian soil. The revival of world trade is only possible if the sterling *bloc* is unloo ened, and the impediments to trade between countries are removed. During seven War years, the U. S. A. had become the second best customer of India, next only in importance to Britain. Opportunities for India to have profitable export market in the U. S. A. are there in plentitude which are not as yet properly understood or appreciated by our people. This is a scheme which is possible, and must be taken in hand without further delay.

Apart from the technical and legal guarantee of Britain, the proposed American loan to India is underwritten by the resources of our sub-continent and a people of 340,000,000 who are surging forward to reach their freedom and obtain a place of honour and self-respect in the comity of nations. This loan would not be frittered away by India, either for paying off any debts, which we do not have, or for financing military or other wasteful projects. It is distinctly understood that this loan would be utilized for the purpose of helping the country to get a move on with her deve opment programme, on which the present executive Government of India have drafted copious tomes and the Bombay Planners offered suggestions of enormous importance. It is to be equally well understood that this loan would be for the purpose of enabling this country to buy her industrial and other equipment from the non-sterling countries in particular, the assurance being that the U. S. A. would become the principal supplier from this defined portion of the world.

I would suggest the formation of a Mixed Commission of the U. S. A. the creditor, India the debtor, and Britain the guarantor, to this loan. This Mixed Commission is to be charged with the task of scrutinizing the plans of the Government of India for industrialization through purchase of equipment from hard currency countries, and also to supervise that the money made available to the Government of India is not frittered away in any deleterious manner. The Mixed Commission would necessarily have powers of a plenary character to ensure the application and service of this

loan. India would benefit from the guidance given by American and British experts on this Commission, as regards the allocation of the funds to be made available through the proposed loan. The Americans, on their part, would have the guarantee that increased industrialization in India would mean a spurt forward in the standard of living of our people, who, being a fifth of the human race, offer the Americans a potential market of enormous significance to themselves and to their export trade. Finally, Britain would not be faced with the awkward situation of a free and resurgent India pressing forward for the *immediate settlement* of sterling credits. In any case, Britain would have discharged a function by India for which her responsibility is primary. Additional to these advantages, the suggested loan would eliminate, as much as possible, international competition, particularly Anglo-American competition, in Indian markets This is an advantage, whose significance cannot be lost upon the statesmen of the world who are at pains to demolish trade barriers, and to ensure the ordered replacement of the material equipment and assets which were destroyed during the recent seven War years.

I venture to hope that the scheme outlined above in its barest skeleton is something which is worthy of notice from India's political leaders, and from the spokesmen of the British Government and the Government of the U. S. A. I have a conviction, born out of a considerable personal knowledge of the intricacies of the problems involved in the above scheme, that its implementation would be hailed as a landmark in international relationships. This is a scheme based on the inescapable obligations of Britain to India, the inherent rights of India to a square deal, and the trade possibilities of the U. S. A. in the future. If a scheme of this type is not found acceptable by the parties concerned, I foresee great difficulties and complications for every party concerned. A solution along the proposed lines in bound to improve Indo-British relationship and pave the way for enduring goodwill and co-operation.*

*This article was sent for publication on 20th June, 1946, but the analysis and suggestions it contains apply even today.—Ed. Bd.

POST-WAR TENDENCIES IN INDIAN BANKING

BY

B. T. Thakur

War has given considerable stimulus to the development of Indian banking. Not only there has been an increase in the number of banks working in the country, some of them very large and show solidness and verility, but the resources of banks have multiplied to a very large extent. Before the war the deposits of Indian Scheduled Banks were less than Rs. 250 crores but today this figure is of the order of Rs. 1,000 crores.

An obvious question which is uppermost in the minds of our countrymen is whether the progress made by Indian banks is of a permanent character or there is likely to be recession in their activity. think I can safely say that so far as volume of banking business is concerned. there should be no reduction. Due to several circumstances, progress of banking in the past was slow ; but many favourable factors have arisen which must ensure continued progress of our banking. Some of these factors are :—

(i) Experience and technical knowledge acquired by Indians,

(ii) General growth in economic activity of the country,

(iii) Decrease in the activities of money-lenders, and

(iv) Large scope for expansion.

There is a definite co-relation between banking activity and amount of money in circulation. In the case of India this co-relation has been very poor in the past, much below that of many other countries ; and even today in spite of large increase in our notes in circulation and deposits alike, our co-relation is much smaller than that of other countries. Even if contraction in currency takes place, though I doubt if it would actually take place, the forces working for increase in bank deposits are so many and powerful that their combined strength would more than neutralize the effect of decrease in volume of currency.

In spite of considerable demand for public loans and finance for the purpose of war, Indian money market has shown a degree of strength beyond the expectations of many ; and the money rates have been low. In this tendency of lower rates of interest likely

to continue, is another question which agitates both the depositors and borrowers alike. Here too I think I can safely say that we are in for a continued era of easy money rates. Improved technique and experience gained by banks of issue all the world over clearly indicate that interest rates must tend to be lower and lower. Banks are now regarded more as custodians and safe keepers of people's money and the question of interest for the use of such money is receding in the background. Vast sehemes of economic expansion which India has on its future programme must also require cheaper credit for their successful fulfilment.

Some months back, a Bill was introduced in the Central Legislature for the purpose of regulating banking business in India. Some may regard this as a measure of undue interference in private business. But ideas about functions of government and public control on important basic economic activities like banking, are undergoing such swift changes that it should be impossible for banking in any country to escape certain amount of governmental or quasi-governmental control. The Federal Reserve Board in the United States of America has vast powers in regulating rates of interest and reserve requirements of banks. Even in England, which uptil now was the greatest stronghold of non-interference in banks and public business, changes are taking place which to the orthodox mind must seem very revolutionary. The Bank of England not only transfers the oldest bank of issue from private hands to public ownership; but it gives the British Government through the Bank, vast powers over other banks. In India banks should be prepared for increasing influence of Reserve Bank or some such agency in their working and policy.

A question has been often put to me about scope of small banks in our credit system. If worked on right lines, I think they are a necessary and valuable part of the Indian credit structure. They must, however, observe the limitations under which they are working, and not ape the bigger banks. They do not possess large resources nor have they the benefit of very capable and experienced executive. They must restrict their operations within their areas of influence and depend upon personal contact as a means of fruitful service. Small banks which work with such safeguards must not only prove a very necessary element in our economic life but on account of the increasing protection which the bigger banks and the

In certain banking quarters further objections have been raised to the nature of scrutiny demanded by the Reserve Bank in connection with the discounting of bills of exchange or promissory notes. In this regard, it is laid down that "when accepting a bill, the Reserve Bank will expect the scheduled bank concerned to supply the Reserve Bank with continuous information relating to the parties from whom it takes these bills, their credit standing, the line of business in which they are engaged and for which each bill is drawn, their other liabilities so far as known to the borrowing bank from time to time, and other relevant data so as to enable the Reserve Bank to maintain a continuous check both as to the soundness of the security and the nature of the transaction to which it relates. The Reserve Bank reserves the right to make an independent investigation of the standing of the party and of the nature of the transaction through any agency available to it." It is not unnatural that such a procedure should cause some amount of irritation; but the popular grievances are mostly founded on a widespread misconception as to the functions and obligations of a central bank. It should be duly appraised that the Reserve Bank as the bankers' bank must carefully safeguard itself, and should, through its influence, try to regulate the business of the member banks. This is in the interest of the banking system as a whole as well as the member banks individually. In any case, it is imperative that the Reserve Bank must protect itself from the farthest possibility of being involved in fraudulent transactions or bad business. In doing so, it is necessary to invest it with certain extraordinary rights and privileges and this too in the common interest of the banking business. With the growth of mutual confidence and dependability, however, the occasion of exercising the rights and powers will become more and more rare, and at length, they will be retained as mere prerogatives to be revoked at times of emergency.

Lastly, it should further be noted that the bills of exchange and promissory notes eligible to discounting in the proposed Bill Market must necessarily be drawn in the proper manner and in conformity to the conditions laid down in the Indian Negotiable Instruments Act, so that they may be acceptable as sound legal instruments.

Here it should also be recalled that heavy stamp duty now prevents the use of bills to any considerable extent. The abolition of the present stamp duty on bills, rightly condemned as 'nuisance tax', was recommended by the Hilton Young Commission and

subsequently endorsed by the Central Banking Enquiry Committee. But as yet, Government have done nothing to implement this recommendation. It cannot be overstated that in spite of other conditions being fulfilled, the exorbitant incidence of stamp duty will stand out as a serious obstacle in the way of developing a Bill Market. The incidence of the duty is all the more pernicious on agricultural bills, and it comes to be more keenly felt when the bank-rate falls.

Constitution

The constitution of the proposed Bill Market practically follows from the conditions laid down above. In fact, the counter of every scheduled bank and of the Reserve Bank will form an integral part of the Bill Market inasmuch as they will accept bills for discounting or re-discounting Still, however, for better facilities it is suggested that an open market be established in places like Calcutta, Bombay and Cawnpore under suitable public organizations constituted after the pattern of Stock Exchange Associations. The principal function of this organization would be to regulate all transactions in bills, *hundis* and other allied negotiable instruments of the money market, and to take such steps as would be deemed necessary from time to time, to check fraudulent activities of designing persons. Membership of the association should be restricted to the following :

(i) All the *scheduled banks* having their offices in Calcutta, Bombay, and Cawnpore (i. e. at the centres where such bill markets are proposed to be installed in the first instance), and intending to participate.

(ii) *Provincial co-operative banks.* These institutions, with a network of smaller organizations, play a vital role in the movement of agricultural finances The prospects of post-war development of Indian agriculture, if properly explored, will vastly increase the demand for rural credit, and with the establishment of licensed warehouses and growing popularity of agricultural bills, the proposed market will come to be the fountain-head of easy finances. But in this respect at least, the measure of success will depend upon the effective irrigation of financial resources through suitable channels down to land and and labour. This would, however, be

possible only by linking the provincial co-operative banks and through them the entire co-operative system to the central money market.

(iii) *Indigenous Shroffs.* In the Indian money market, indigenous shroffs occupy an important position. Though in general public opinion in the country seems to disfavour the activities of many, there is no denying that these indigenous bankers, in their traditional way, operate in a field where commercial bankers are still hesitant to enter. It is doubtful if at any time the entire field of their activities can be covered by modern banking institutions without risking themselves too much. Nonetheless, these shroffs will continue to fill in certain unavoidable gaps in our credit structure for many years to come, and hence it would be imperative to consider their eligibility to membership of the Bill-Market Association. Of course, all the shroffs cannot be admitted to membership without discrimination, nor can all of them claim unquestionable status and solvency, But shroffs of accredited business integrity should necessarily be included in the list of membership.

(iv) *Licensed Bill-Brokers.* As in the case of stock-exchange associations, there should also be another class of members, especially experienced in dealing with bills, i. e. the licensed bill-brokers. Through the agency of these brokers, it will be possible for ordinary public to invest in the bill-market. This when sufficiently popularised will go a long way to mobilise resources in possession of private individuals to the benefit of all.

Conclusions

The urgency of popularising the bill system and of installing an organised bill-market will be widely conceded to-day. In fact, there have been prolonged discussions in the past and though difficulties have been fully weighed, the economists have always emphasised the need for bold initiative. Until the creation of the Reserve Bank of India the situation was admittedly different and Government initiative in the matter could hardly expect easy fruition. But now the general conditions have improved, and improved substantially.

The Reserve Bank has obtained appreciable control over the money-market in the country, and the Indian banking system is no longer shrouded in ill-understood secretiveness.

It is not, however, maintained that difficulties are none, nor is it argued that the entire scheme can be put to smooth working all at once. But the path of possible action is definitely much better laid now than before, and there is no reason why bold initiative and courageous enterprise in the right direction should fail. Moreover, the time-factor has assumed greater importance now. In the free India of today, bold measures will have to be taken to grapple the country's problems, and it should not be impossible for the authorities to undertake a course of action in consonance with the scheme proposed herein. Further, it cannot be repeated too often that economic regeneration of the country, postulating rapid expansion of agriculture and industries, will demand complete mobilization of our financial resources and their diversion into productive channels. Organization of the proposed bill-market will serve this purpose well. Lastly, it will be of no little advantage to the Government, inasmuch as they will receive wider financial support in respect of their time-bonds and treasury bills. It is, therefore, urged that the Government of India in consultation with the Reserve Bank should take into their immediate consideration the scheme put up here or any workable alternative, to establish organized bill-markets at major commercial centres in the country like Calcutta, Bombay and Cawnpre.

STOCK EXCHANGE REFORM

BY

K. L. Garg

One of the most important pieces of reform that is long overdue is that of the Stock Exchanges. At times, it has been admitted by various economists, writers and politicians that speculation is an evil and must be checked or controlled, so much so that two former Indian Finance Ministers, Mr. Liaquat Ali Khan and Mr. Shanmukham Chetty referred to it in their budget speeches and promised to formulate necessary legislation in this direction. But nothing tangible has yet come out. This shows the importance of the subject and its difficult nature.

Speculation, it must be understood, is a necessary evil and thus cannot be checked with advantage. It can be regulated so as to free it from its inherent weaknesses without in any way disturbing the financial structure. The main function of speculation is to promote the establishment of equilibrium of demand and supply in the market and thus to help in the smooth course of consumption, production and exchange. The function of a Stock Market is to provide a ready and easy convertibility of securities and thus enable the industries to obtain the necessary finance. The Stock Exchange thus serves a useful purpose as it provides necessary mobility to capital and directs the flow of capital into profitable and successful industrial enterprises. But it is not free from its shortcomings and of late has been responsible for much hectic speculation and overtrading.

During the war period the Stock Markets were all the more disturbed and disorganized mainly because of the wide fluctuations of security values which were due to the circumstances of war which brought enormous fortunes to the Indian merchants through black-marketing, profiteering and hoarding as also through the immense increase in currency notes in circulation. Prices improved all round and hectic fluctuations were witnessed on the declaration of war. In

May, 1940, surrender of France affected Stock Exchanges adversely. Special measures were undertaken to control the trouble. Calcutta market was closed for six weeks and forward trading was suspended. A ban on 'Budla' (carry over) was imposed at the Bombay Stock Exchange in September, 1943. In addition a number of other measures such as the ban on forward trading in cotton, dividend limitation measures, cloth control order, restrictions on company flotation and measures to control speculation, were responsible successively for the disorganization of Stock Markets during the period. The Defence of India Rule 94-C did more harm than good. Instead of putting a check on the highly speculative tendencies of the operators, it aggravated them. Business was diverted to 'Grey Markets' and price manoeuvring and manipulations gained ground and *bona fide* sellers were handicapped and short sellers were penalized for performing their normal functions. But at the same time there are certain inherent defects of the present Security Markets in our country because of the non-existence of a rigid and rigorous piece of legislation, like that of National Security Act of U. S. A. The practices of our Stock Exchanges widely differ from each other and they need a thorough overhauling.

It is more often suggested that speculation should be checked in all possible ways. To my mind this is not a feasible solution and would be just like killing a patient with a view to cure him. The patient needs proper diagnosis and medication so that he may exist and render necessary service. Stock Exchange practices similarly should be guided and regulated on sounder lines so that the speculators may not be able to take undue advantage of the situation and the market may be free from all manipulations of the stock brokers and that the speculation may be carried on with all the ability and foresight and may serve the interest of the investors.

Healthy speculation that is based on scientific knowledge of business conditions is always advantageous and must be fostered, while, on the other hand, unhealthy speculation which leads to gambling is a social evil and brings about much injury and waste. There should be a fine line of demarcation between the two. When speculation is carried on the basis of unfounded rumours and imperfect knowledge of business conditions, it brings about economic disturbance and is responsible for much waste. It simply enables the individuals to fulfil their selfish motives and is injurious not only economically but socially and morally as well.

Regulation of speculation and Exchanges is therefore an urgent necessity and if our country is to be industrialized and the industries are allowed to develop on sounder and modern lines, it is highly necessary that Stock Exchange reforms should not lag behind.

The main problem that confronts us is lack of unity amongst the various Stock Exchanges of the country. Though they specialize in one or more security because of localization of industries, yet their practices widely differ from each other. The various enactments and regulations made under the Defence of India Rules cannot continue for long and it is necessary in the present conditions when the country has achieved independence that some sort of legislation on an All-India basis must be enacted to unify the practices of the various Stock Markets. The *ad hoc* measures taken by the Government from time to time will not solve the problem and a permanent government machinery which would watch the activities of the Exchanges and take suitable measures with a view to safeguard the interest of the investors and of the nation as a whole, is needed. The Government machinery so set up would not only coordinate the activities of the various Exchanges of the country, but at the same time would bring about permanent reforms in the practices of Stock Exchanges. Stock Exchanges form great financial centres and their failures on various occasions in Delhi, Kanpur, Madras and at various other centres have led to the weakening of confidence of the investors, and with a view to provide adequate financial facilities to our industries this confidence is to be restored. Whenever any new Stock Exchange is to be started, the possibility of its success must be carefully examined and its rules scrutinized so that a new Stock Exchange can only come into existence after the sanction of a competing authority. It is, therefore, necessary that with a view to develop the investment habit amongst the Indian public, an All-India legislation to control and unify the activities of the Stock Markets must be enacted.

We agree with Dr. Thomas that a provincial action in this respect would not be effective as a large part of the Stock Exchange business is in inter-market counters and manipulations and pool activities are all on an All-India scale and to curb them an All-India Legislation is highly necessary. Further, uniformity of business and practice will not be achieved if the administration of Stock Markets is left in the hands of the Provincial Governments.

Not only speculation on Stock Markets is to be controlled directly by introducing a rigid All-India Legislation with a provision of a Controller of Stock Exchanges, vested with wide powers and having jurisdiction over all the Stock Markets of the country, assisted by certain office assistants watching the daily progress and development of these markets, but also by adopting all such measures which will restrict the scope of speculation, in other words by minimising the facilities of speculation as well. With the introduction of Stock Exchange Legislation, it may be necessary to reform the Company and the Banking Laws as well. The Directors and the Managing Agents who take advantage of their position and have, at many times, been responsible for the leakage of certain information much in advance to their relatives and friends, who in turn take undue advantage at the Stock Market at the expense of the investing public, should be liable to severe punishment and the provisions should be so modified that the necessary information may be available to the public at the proper time. It may also need a control of corporation dividends as also a control of investment for which the establishment of an Investment Board may be necessary. The byelaws of all Exchanges should be subject to the approval of the Controller of Exchanges and a uniform policy should be formulated regarding the methods of business. In brief, every detail should be supervised, controlled and regulated by the Controller and the Investment Board.

It must, however, be noted that this piece of legislation, which may be in the process of preparation at the Finance Minister's table, should not unduly restrict the business, because in that case the business shall be diverted from the floor of the exchange to uncertified brokers and to "Gutter Markets." In no way the freedom of the market which is so essential for the investor and the speculator should be curtailed. The main object of legislation ought to be to see that speculation is not allowed to go beyond reasonable bounds.

In this connection, it shall also be necessary that the brokers are provided proper training regarding Stock Exchange technique and practice. The work can conveniently be taken up by the Investment Board and the Government should set up a Stock Exchange Research Organization to carry on the necessary research with a view to reform the investors and the market alike.

While framing the legislation, we cannot afford to neglect the conditions prevailing in other advanced countries like U. S. A., England, etc. As pointed out above, we cannot run completely on the lines of socialistic economy under the present circumstances and close the Forward Trading at all. Forward Trading must continue under proper control and for this purpose it will be necessary that Ready and Forward Deliveries should be unambiguously defined. The forward business, when suspended during the last war, was carried on under the disguise of Ready Delivery which was restricted to eight days. It is too long a period and provides opportunities for manipulations. The period of currency of forward contracts should be precisely defined and should not be a long one. The introduction of the system of margins is of immediate necessity with a view to check the speculators from trading beyond their means, and with a view to carr on Forward Contracts on sound lines as also to restrict the magnitude of speculation. A provision to this effect has been made in the recent legislation on Stock Exchange in South Africa, under which the client is required to deposit with the broker such securities as will provide a minimum cover.

The non-existence of a system of margins makes possible for the people of small means to trade on the market and this often leads to overtrading. From time to time various schemes of margins have been suggested as a preventive to corners and crises. Morison Committee, for example, was in favour of a simple system of margins as in its opinion a complicated system would either be evaded or be ineffective. The Committee simply indicated the directions for a system of margins with a view to impose a check on the initial transactions and discourage its prolongation beyond the due date of the original settlement. The suggestions of the committee referred to (a) a percentage margin on the initial buying price (bargain price), (b) an additional percentage margin on the making-up price at the first settlement if the security is carried over and (c) further additional percentages as supplementary margins at each of the following settlements.

Mr. A. D. Shroff in his evidence before the Morison Committee suggested a system of margins under which every broker was required to submit every day a list of the transactions at the over-night closing time in order to prove that he had the requisite margin from his clients. He wanted the Government to take power under the

Bombay Securities Contracts Control Act, 1925, to permit forward dealings only under prescribed margin requirements with power to vary the margin from time to time in consultation with the Stock Exchange Authorities. As for him, mere initial margin was not enough, but was to be maintained at the required level as the transactions increase, with a slight concession in respect of time to up-country clients and the same restrictions to apply to brokers or firms who deal in their own accounts.

Recently a scheme of margin has been drafted by Mr. K. R. P. Shroff, President, Bombay Stock Exchange. The scheme provides for a 10 percent margin to be demanded when there is a fall of 10 per cent or more and no margin is to be called when there is a continuous rise in prices. The broker under the scheme has the option to demand an initial and additional margin if he so desires. But the client is not obliged to put up the margin. It is a matter of agreement between the two. But in actual practice if initial or additional margin is required by the broker, the client would always submit it, but for fear of losing the client the broker will not do so except in exceptional circumstances.

The scheme drafted by Mr. K. R. P. Shroff seems to be one-sided only and may be said to be Mandi Scheme, as no margin is necessary in case the price rises beyond the budli price. It will thus encourage short-selling. But at the same time it does not seem at all necessary that a margin settlement should take place, whenever the prices rise beyond the budli price, as any rise in price will automatically push up the margin. But at the same time in any scheme of margin it should be provided that the margin should not be allowed to fall below a certain percentage by any rise or fall in price and should be maintained at a fixed level. Then only speculators would be prevented from dealings beyond their limits and real purpose of margin requirement shall be fulfilled. Thus a modest beginning may be made in this direction by providing for an initial deposit as also for the maintenance of the margin at a fixed percentage. Though a scheme of margin cannot abolish speculation totally, but what is needed is to restrict its magnitude so that dealers may be prevented from speculating beyond their means. A system of margins undoubtedly discourages over-trading and excessive speculation and provides a protection to the brokers from the possible weakness of the client and guards them against

their poor finances. It is therefore desirable that a provision for margins should be made in the legislation and the margin should be kept deposited by all, whether a member or a non-member, with some Stock Exchange authority, preferably the Clearing House and should not be allowed to fall below a certain percentage, though a little concession in the matter of time may be allowed in the case of upcountry clients.

This provision of margin or minimum cover should not apply to the investors only, but to the brokers as well and may safely be kept deposited with Stock Exchange Clearing House. Provisions to restrict the activities of speculators beyond their means should also be made ; for example, loans against the securities of shares by brokers should be prohibited and the loan advanced on the security of other assets should not also exceed beyond a certain sum. At the same time the interest of the investors should also be safeguarded and in no way the brokers be allowed to take undue advantage of their position over the investor; e. g., a broker should be prohibited from selling his own holdings to a client or from acquiring himself the client's holdings without the client's permission and a disclosure to this effect must be made on the Broker's Note. Provision should also be made for the Audit of Brokers' Accounts and any infringement of rules and regulations framed under the law should be severely punished.

At the Bombay Stock Exchange, the most prolific source of overtrading is the activity of a class of members of the Exchange, who are not brokers in the real sense of the term, i. e. men who live on remuneration for the sale and purchase of shares on behalf of *bona fide* customers. Some members, the so-called brokers and mis-called jobbers, carry on what is known as tarawani business which is entirely of a parasitic nature. They rush in to buy or sell according as they find *bona fide* brokers trying to execute buying or selling orders. Their operations necessarily result in price movements almost always to the detriment of clients' buying or selling. These tarawaniwalas hardly keep any outstanding business overnight and they continuously go on buying and selling at a small range of fluctuations. Their actions are nothing but gambling in differences. This leads to consequent overtrading which at times has resulted in disaster and crisis. This state of affairs should be reformed. But as the size of business at the present time does not warrant a permanent classification of members into brokers and jobbers, which is very desirable, the members should declare at the beginning of each year whether they wish to act as a broker or a jobber or both and the

management must see that the decisions are scrupulously adhered to. This will protect the *bona fide* brokers from the uneconomic competition from jobbers who will be debarred from dealing directly with the public. At the same time, investors will be assured of a fair deal through *bona fide* brokers, if they make a right selection.

Besides the system of blank transfers, so rampant in the country, should be properly regulated. The use of blank transfers affords an opportunity for further speculation. Under the present system, the seller transfers to the buying broker a blank transfer form duly signed together with the scrip and the buyers do not get their shares registered in their own names at the company's offices, as they intend to sell these shares again as soon as the market improves. No doubt the system encourages speculation but owing to the peculiar conditions of the country which requires capital for its industrial advancement, it is not feasible to abolish the system of blank transfers. But its period of currency should be restricted to three months and an all-India legislation should be enacted to this effect. But at the same time, it must not be lost sight of that the present practice of using blank transfers is to a large extent due to high scale of stamp duty on transfers. If the rate of duty, therefore, is made nominal, the practice of using blank transfers will be considerably curtailed.

Provision should also be made for the Government representation on the governing bodies of Stock Exchanges, as in the present state of affairs when internal management and discipline is to be developed on sound lines, such a representation may prove very fruitful. Then again such a representation, as pointed out by Dr. Thomas, is also necessary because the Stock Exchange has its own repercussions 'on the banking system, credit structure, trade, commerce and on the general security of the country.' Besides such a representation has worked well in U. S. A. and is likely to work well here as well.

Private compromise, though punishable under the rules of the Bombay Stock Exchange, is very common in Bombay and provides an encouragement to unhealthy speculation. On the Bombay Stock Exchange, there exists a Defaulters' Committee, but the Committee seems to have no work. This laxity in the enforcement of rules further encourages reckless and irresponsible dealings at the Stock Exchange, as the members know that, if they overtrade, they have more to gain than to lose since losses have not to be paid in full

and can be compromised. Such a compromise should not be permitted as the members who may be in a position to pay may make a compromise and creditors may suffer for nothing. The Defaulters' Committee should go into the whole question of investigation. The rule should be rigidly enforced with a view to remove unscrupulous defaulters from the market who take undue advantage of the market conditions. The Morison Committee was also not in favour of compromise when it observed that compromise in any shape or form in order to avoid default should be prohibited under pain of severe penalties.

Under the present rules of our Exchanges, authorized clerks are not permitted to make bargains in their own names, but they are not prohibited from dealing for themselves. They can buy and sell on their own account through a member, in the name of a member and under his instructions. This leads to a serious abuse. For example, if a clerk has a large order to be executed in the market, he can first deal on his own account at the advantageous price and his employer or the client might be the victim. Such authorized clerks should not be allowed to do business for themselves and any member permitting his authorized clerks to enter into business on their own account should be fined and for repetition gradually suspended and expelled. At the same time, these clerks should be permitted to enjoy certain benefits and privileges. They should be provided with better prospects. Their minimum scale of pay should be laid down by the Exchanges and a number of seats for membership should be reserved for them.

Provision should also be made for the protection of the investors from investing in unsound companies through listing regulations of the Stock Exchange which should call for such information as would enable the Listing Committee to judge the soundness of the company and provide for closer scrutiny of securities before they are actually listed and shares are allowed of a market on the Stock Exchange.

To restrict the magnitude of speculation, it is also necessary that the list of securities should be widened and opportunities provided for a large number of investors. At the Bombay Stock Exchange, shares of only those companies can be traded in, which keep a register in Bombay. This is not a very desirable restriction. There is no reason why shares of companies having a register in

various parts of India should not be permitted. This would widen the field of business and would reduce wide fluctuations. In addition deferred shares are by their very nature more speculative and it will be in the interest of the investing public if they are removed from the forward list at the Bombay Stock Exchange. Such shares lend themselves to speculative activity of an uncontrollable character and at times have been a source of impoverishment and trouble to many. Such shares have been a cause of panic on the market and the desirability of removing them from the forward list may be considered with advantage, with a view to check unhealthy speculation.

In order to provide additional business facilities to investors, the number of shares should be increased. The denomination of a share should be lessened There is a general tendency in Calcutta towards shares of small denominations, while in Bombay towards large denominations. From the point of view of general economic conditions, the shares of small denominations seem to be better fitted to India. The large denomination shares are suitable for speculation and there are great chances for their cornering. Lower denominational shares will stimulate the small investors to put their savings in them and corner possibilities would become rare. To achieve this object companies having shares of large amounts should be persuaded to split them and, if necessary, Government might intervene.

Better facilities should also be provided to the investors with regard to market quotations. The quotation service at our Exchanges is the poorest in the world. The present blackboard at the Bombay Stock Exchange should be replaced by electric boards which should show the current market prices of active securities from time to time. The present blackboard is often behind time. Electric or mechnical tickets are also desirable and should be introduced as soon as possible.

INDIA'S STERLING LOAN TO BRITAIN

BY

Sir Abdul Halim Ghuznavi

The vast sterling debt which Great Britain owes to India has been a major factor in the Indo-British relationship for some time past. The manner in which the loan was taken from India, as also the question of its redemption, have been engaging the attention of our economists, industrialists and politicians for some time past; but so important, fundamental and enduring is the whole problem that for at least some time to come, it is bound to rank among India's leading economic issues till it is satisfactorily solved. Even as a chapter in the economic and financial annals of the country, it is bound to have determining effect on the future relations between India and Great Britain.

Our sterling loan to Britain has been called from its very outset as India's Sterling Balances. India's accumulation of huge sterling balances is, in the present-day context, a war-time phenomenon which on the one side has led to the transition of this country from a debtor to a creditor nation and, on the other hand, has brought untold sufferings to the people of this country by means of an inflationary financial expenditure the like of which has not been experienced by this country before There has been nothing unusual in the accumulation of sterling for India up to a certain limit, even before the War, as a backing for India's currency in accordance with the Reserve Bank Act. No one, however, could realise the implications of the accumulation of sterling by the Reserve Bank till India was exposed to the actual dangers of galloping inflation. Until lately it was not realised that this harmless provision which authorised the Reserve Bank of India to keep jointly gold bullion and sterling securities as the backing of India's currency could be utilised to finance the economy of the country in a most unorthodox manner regardless of its effects and the consequences on the people. Under normal circumstances, when sterling was freely convertible into gold and represented purchasing power in international trade, the accumulation of sterling by the Reserve Bank of India was not found objectionable. But with the outbreak of the World War II, the conditions materially changed. Sterling was no longer a free

currency. Under war-time restrictions and exchange controls, sterling no longer provided an international purchasing power. This was a very significant change in the position of sterling and its qualification to continue to back India's currency to an unlimited extent became most doubtful. However, this is only a part of the story. It was not in the least expected that this formerly innocent currency mechanism would later be used by H. M. G. to build up enormous credits to finance their almost unlimited war expenditure at the expense of the creditor country itself. By means of this currency mechanism, India has accumulated sterling which stood at £ 1,160 million (or Rs. 1,547 crores) in June, 1948, immediately before the commencement of negotiations between the two countries. It is well to realise beforehand the extent and stature of India's sterling balances which represent at least fifty per cent of her national income and amount to twice the total capital invested in Indian industries before the War. Undoubtedly, the accumulation of such vast sterling balances and the problem of their disposal should and must have a great effect on India's economy.

In a broad sense, sterling balances consist of all War-time capital claims held by Governments, Central Banks, Currency Institutions and individuals outside the U. K. against gold and foreign currency controlled by the U. K. As already explained, India's sterling balances have been a part of her currency system even before the War. It was during the War that His Majesty's Government realised the possibilities of utilising the Reserve Bank Act to finance their heavy War expenditure in India. The War proved the great strategic importance of India as a valuable military base. The War with Japan brought a number of British troops into this country and the defence expenditure of H. M. G. in India went up at a great speed. It is estimated that from 1939-40 to 1944-45 out of a total expenditure of Rs. 2,250 crores in India, H. M. G's share was to the tune of Rs.1,400 crores. According to any sound principles of public finance, this expenditure could be met only by providing the requisite rupee finance in this country. For this purpose H. M. G. could have either raised rupee loans in India or exported capital equipment and developed new industries in this country as was done in the case of certain other countries to enhance the productive capacity for meeting War requirements. H. M. G. could have also added to their rupee resources by liquidating British investments in India as they did in the case of the U. S. A. before Lend/Lease. But none of these

methods was utilized to meet the growing War expenditure in India. Instead, India witnessed a novel method of financing the War and raising rupee funds for H. M. G. The situation was met by accepting paper promises of H. M. G., named sterling securities; and by issuing currency notes against them. These balances, which accumulated on various accounts, were invested and re-invested in British Treasury Bills (bearing ½ % interest); and they were included in the assets of the Issue Department of the Reserve Bank of India which printed one-rupee notes against their backing and gave them to the Government of India for making purchases for H. M. G. This method gave to H. M. G. the freedom of spending in the country almost without any restrictions. As currency circulation was increasing every day, the rise in prices caused further expenditure to H. M. G. which led to further growth of sterling securities and in turn to greater inflation. The goods supplied to H. M. G. in India in the ultimate analysis became available because of the reduced consumption of those whose purchasing power fell on account of the rise in prices. It, therefore, in effect became a type of *forced loan* from a class of people in India who could least afford it. Sterling securities, therefore, became the basis of India's currency expansion. The following Table would indicate the relation between the growth of the sterling balances and the rise in the currency circulation:

TABLE

Sterling Balances and Notes in circulation

Year	Sterling balances with the Reserve Bank of India	Notes in circulation
	(Crores) Rs.	(Crores) Rs.
1938-39	71.16	182.4
1339-40	90.97	209.2
1940-41	169.24	241.4
1941-42	211.03	307.7
1942-43	394.22	513.4
1943-44	755.24	777.2
1944-45	1182.20	968.7
1945-46	1549.49	1162.6
1946-47	1662.71	1223.0
1947-48	1542.27	1227.8

It is interesting in this connection to ascertain the composition of India's stetling balances. Apart from the accumulation of sterling balances on account of His Majesty's Government's defence expenditure in India, there are certain other important items which go to make up the present figure of our sterling credits Firstly, they include all India's dollar and non-sterling assets including India's excess balances from normal trade which are compulsorily acquired and taken over by the Empire Dollar Pool. Secondly, they represent India's favourable balance of trade with the U. K. during the War. Thirdly, they include direct purchases of India's raw materials and food by the British Ministry of Supply for meeting defence requirements. It is not difficult to realise from this classification that the nature of the accumulations under the above headings, excluding defence expenditure, is that of purely commercial obligations incurred by Great Britain. There should not be any question of the adjustment of this credit except as a commercial obligation, as far as India's sterling claims are concerned. Out of these sterling accumulations, the figure relating to India's favourable balance of trade with U. K. during the War, alone, amounted to about Rs. 370 crores. The total British purchases in India might be calculated to amount to over Rs. 500 crores during the War. Similarly, when the details of the Empire Dollar Pool are published, it would also amount to a considerable figure. This would indicate that a considerable portion of our sterling assets is in the form of purely commercial obligations of the H. M. G. in India.

It might also be helpful to say something about the defence expenditure as a whole. According to the Financial Settlement negotiated with H. M. G. in 1929, the Defence Budget of India was to compose of (*a*) India's pre-war normal budget of effective charges, Rs. 36.77 crores, (*b*) a sum to adjust the normal budget for a rise in prices, (*c*) the cost of Indian War measures which were to be regarded as purely Indian liabilities having been undertaken by India for her own interest, (*d*). contribution towards the additional cost of her external defence. By virtue of this Financial Agreement and lack of clarification of the joint War measures, the Government of India practically agreed to pay for a great part of the War effort of the British Empire. The extent or the financial burden that is to be borne by India as a result of this Financial Agreement goes to prove that India has been made to pay much nore than was warranted for

her own defence. India's defence expenditure of Rs. 50 crores before the war increased to Rs. 458 crores in 1944-45, meaning thereby an increase of nine times of the pre-war defence budget. India's total defence expenditure during the war represents more than thrice the total net expenditure of the Central Government during the eight years before the war. Indeed, the Table below shows that though our defence expenditure again register a rise after the vivisec-

TABLE

Defence Expenditure of India

Year				*Defence Expenditure* (Rs. Crores)
1938-39	...	...	...	46 18
1939-40	...	...	...	49.54
1944-45	...	...	...	458.32
1945-46	...	...	...	395.32
1947-48	(Revised)	...	...	86.63
1948-49	(Budget)	...	...	121.08

tion of our country, it is today a small fraction of what was spent in 1944-45 and 1945-46. Such a vast expenditure was incurred by the Government of India irrespective of the economic conditions of the country and the capacity of the people to pay. The finance of this expenditure by the issue of new currency notes backed by additional sterling credits came in handy to His Majesty's Government.

Any consideration of India's national income would clearly reveal that India's contribution to the war effort had been much in excess of her capacity to pay. The economic and financial burden that a country can bear is ultimately dependent upon the size of its national income and income *per capita*. If the U. K. can contribute fifty per cent of her national income towards the war expenditure with a *per capita* income which is fifteen times more than India's, there is every justification that Indian expenditure should be proportionate to her total wealth. Comparative data regarding the size and *per capita* income of countries like the U. K., U. S. A., Canada, Australia and India show that India's burden of the war effort has

been more than should have been proportionately levied. In return for the sacrifices that India made to the war effort, quite out of proportion of her capacity, she suffered inflation resulting in the collapse of her entire economy and untold sufferings and privations to the people of the country. While most of the Allied Nations, like the U. S. A., Canada, Australia and the U. K., had kept their consumption level not only at par with pre-war conditions but had even increased it to a considerable extent, India's consumption level showed a downward trend and ultimately resulted in aggravating the miseries of the people who were already on the starvation line. Almost all the countries including the Dominions showed enormous increase in the volume of their production. On the authority of the economic survey of the League of Nations, the volume of production in the United States nearly doubled during 1939-44; its war production was as great as its national income in 1939. Further, Canada and South Africa provided for the whole of their war production through an increase in the aggregate output. Indian industry, as a whole, on the other hand, did not expand much since 1942. The over-all increase in production is estimated at 20 per cent but the output in certain industries actually declined in 1943 due to shortage of coal, transport difficulties and capital goods. More recently, production has declined appreciably. There is, however, one significant feature of our own economy, i.e., India's repayment of her sterling debts to Great Britain. India had long felt the need of the elimination of her sterling debts, a good portion of which was imposed on her as she had no choice of her own. Accumulation of sterling balances helped India to wipe off her sterling debt which amounted to Rs. 469 crores in 1939. With only this one favourable feature of her war economy, India emerged out of this war, a country shattered economically, without any major industries to give hope for the future and with a famine-stricken people. The only tangible assets to count upon are sterling balances accumulated by the Reserve Bank of India, which may be taken to be her only hope for the future economic regeneration of the country.

This is evident then that India's sterling loan to Britain was compulsorily taken from her and at great cost to her people. But this is a matter of history now and we in this country are prepared to treat it as such, provided the problem of its repayment is settled to our satisfaction. The primary significance of the sterling balances

lies in the most important fact that India is at present very little industrialised; and for further industrialisation we require capital goods, industrial know-how and other means and materials which we will have to import. This will require external finance; and our sterling balances can serve just this purpose. It is obviously in our interest that these balances are released to us at an early date; and that they are made convertible in foreign currencies. That, indeed, has been India's national demand from the very outset. Britain has not been finding it possible to satisfy India in these regards. Indeed, a section of the British Press and even certain responsible persons in Britain pressed for partial repudiation or scaling down of these balances. This attitude was as unjust as thoughtless. It led people in India to suspect the motives of H. M. G. and the British Nation. Happily Great Britain has overcome this attitude and this has removed a great obstacle in the path of Indo-British co-operation. The questions of the rate of redemption and multilateral convertibility of sterling balances can best be settled by negotiations and agreements; and this has been the method that the two countries have followed recently.

The position in the earlier part of 1947 was that India was free to utilise her sterling balances in any manner she pleased for expenditure in or remittances to the sterling area subject only to the limitation of availability of goods in that area. She was also entitled to convert the balances into dollars or any other currency at her own discretion provided she was satisfied that the expenditure involved was essential and in the interests of the economy of the country. This position could not continue for long on account of the provisions of the financial agreement between the U. K. and U. S. A. As a result of this, an interim settlement was made on the 14th August, 1947. Under this agreement, a sum of £ 30 million was released for use by the Reserve Bank of India as working balances and a further sum of £ 35 million for multilateral convertibility. In addition to this a further sum of £ 18 million was made available for multilateral convertibility to India and £ 6 million to Pakistan on the extension of agreement for a further period of six months in January-February 1948, which expired in June, 1948. The main criticism against this, new extension was that the balances now made available for multilateral convertibility were too little to warrant any development in our economic conditions. But we could not utilize even more than £ 3 million out of a total of £ 83 million

released to us. This clearly shows the non-availability of suitable goods that we need for our purpose.

A fresh agreement was later entered into between India and U. K.—the so-called final settlement. On 1st April, 1947, the undivided Government of India took over all the military stores and installations located in India which were the property of H. M. G. The book value of these assets was of the order of £ 375 million (Rs. 500 crores). It has now been agreed that a sum of £ 100 million (Rs. 133 crores) should be paid in full and final settlement for all the stores and installations taken over on 1st April, 1947. India has also agreed to purchase the two annuities worth £ 147½ million (Rs. 197 crores) and £ 20½ million (Rs. 27 crores) to pay off her central and provincial liabilities as regards the pensions to the European officers to be liquidated over a period of 60 years.

The final accounts of the undivided Government of India for 1946-47 showed that a sum of £ 49 million (Rs. 65 crores) remained due from U. K. under the plan for the allocation of defence expenditure between India and that country. Certain liabilities pertaining to the period covered by this plan still remain to be met and after allowing for these the final amount due has been fixed at £ 55 million (Rs. 73 crores).

In view of the various uncertain factors both in the world and in the U. K., the agreement for the multilateral convertibility has been confined to only one year. It will be limited to £ 15 million (Rs. 20 crores) in the first year. As regards the release of sterling, the agreement has been for 3 years ending 30th June, 1951. During this period a sum of £ 80 million (Rs. 107 crores) will be released which together with the balance in Account No. 1 as on 1st July, 1948, would place at our disposal resources amounting to £ 160 million (Rs. 213 crores) over and above our export earnings during this period.

Thus it will be found that amongst the countries of Europe with which India has important trade relation, the only two countries which would still remain hard currency areas for us are Belgium and Portugal besides the Anglo-American Zone of Germany. Other countries have become soft currency areas for us. With regard to Japan, we are entitled to get dollars to the extent of £ 3½ million (Rs. 4⅔ crores) this year out of our trade balance with that country. We are also free to borrow from the International Monetary Fund to

meet our deficit balances in trade. The following Table is illuminating in this respect.

	£ (millions)	Rs. (crores)
Sterling balances (1-7-48) ...	1160	1547
Total Releases	360	480
Balance	800	1067
Normal Currency Reserve ...	200	267
Balance available ...	£600 m.	Rs.800 crs.

Thus India's buying capacity has been put for the next three years at Rs. 213 crores plus the normal exports of £ 500 crores a year, amounting to Rs. 1713 crores in total. Considering the enormous requirements of this country for the coming years, we feel that the amount released is not quite sufficient. But much depends upon the availability of capital goods in the foreign countries. What is really necessary, is the increased release for multilateral convertibility which is unsatisfactory both as regards amount and time. The period of one year is too short to warrant the execution of any plan.

In order that we may be in a position to draw up and launch upon an economic plan, it is necessary that the period as well as time of multilateral convertibility should be sufficiently long. How long should the period be, can be answered from various angles, much depending upon the nature, order and scale of priority of our economic plan.

Besides this, the balances can also be utilised for the liquidation of British commercial assets in India which are estimated to be between £ 300 and 500 million. At home, an essential pre-condition of effective utilization of sterling balances in particular and successful planning in general is effecting certain currency reforms at early date. A reasonable maximum limit to the amount of sterling securities which the Reserve Bank of India can hold in the Issue Department must be fixed. In view of a considerable reduction in our invisible imports in the future, a limit of Rs. 100 crores might be adequate. The minimum of the gold proportion of the currency reserve and the maximum limit to the holding of rupee securities

must be put at a higher figure, and both together should be subject to a minimum proportion of the note-issue. The Reserve Bank may also be allowed to substitute rupee securities for sterling securities to the extent it may deem necessary. With the nationalization of the Reserve Bank of India, we hope the above suggestions will be given adequate consideration and the steps that are taken will not only redeem India from the dangers of inflation but will also put her economy on a stable and firm footing.

INFLATION AND OUTPUT

BY

A. K. Das Gupta

A certain misunderstanding seems to persist in our country in regard to the relation between prices and production. There is a tendency to connect the present inflation with a shortage of goods and an attempt to shift emphasis away from money to production. It is the object of this paper to argue that inflation is essentially a monetary phenomenon and that output in this context is a secondary matter and may be left almost alone.

My own explanation of the post-war inflation in India runs in terms of an excess of expenditure on consumption over that which would just compensate the decline in investment that has taken place during this period. Altogether there are three sources of finance of this excess expenditure : (*a*) dishoarding, or the release of cash balances formed out of past income ; (*b*) increase in the *volume* of current money income ; (*c*) increase in the *proportion* of current money income devoted to spending. Among these, the first and the second are definitely operative. Depression in the securities market is a good indicator of the first and rise in money wage rates is an indicator of the second. It is difficult to say if the third factor is operative too. It depends upon whether there has been a change in the distribution of income in favour of the lower income groups who are more proue to spend than to save. Wage increase and increase in agricultural prices are pointers in this direction. Yet, in spite of the protestations of the industrialists, we would perhaps go off on false scents if we made too much of this or even the second factor. For, in the face of the broad facts concerning the gap between cost of living and wages[1] or between non-agricultural retail prices and agricultural wholesale prices,[2] it is impossible not to believe that these have been swamped by the other and the more significant factor,—dishoarding. It is true that wage increase is an

1 Unfortunately we do not have reliable wage statistics. But I am sure nobody except those who have an axe to grind will contest the general validity of the proposition that wages in our country are still lagging behind cost of living.

2 Agricultural Parity index (Base Aug. 1939) has come down from 156 as in July, 1947, to 120 in July, 1948.

important fact connected with inflation and that stabilisation of prices does imply stabilisation of wages. Yet it is misleading not to recognise that a rise in money wages is more a symptom than a cause of inflation and that until the basic cause of inflation—excess spending—is eliminated, it is preposterous to talk of wage stabilisation. The main thing for us to settle is the level at which price has to be stabilised and then to fix up a rate of wages which will yield a profit margin sufficient to keep up production at a level consistent with full employment. The rate of investment and consumption has to be adjusted accordingly. In the present circumstances, when any substantial curtailment of investment is not possible nor perhaps desirable, this will surely require a considerable reduction in the propensity to consume, and the first charge must necessarily be on dishoarding.[3]

We often hear it said, however, that the one thing that is wrong with our present situation is 'scarcity' of goods, that if prices are to be lowered, what we have to do is just to 'step up' production. Our industrialists and even some of our statesmen—or perhaps their 'economic advisers'—are indeed viewing the problem in this manner. It is even argued sometimes that the 'effective circulation of money,' which is what determines the flow of money income, has declined since the end of the war and that, since the price level depends upon money income relatively to the supply of goods, the present high prices are to be explained solely in terms of the scarcity of goods.

This is a myth which requires exposure. The protagonists of this view not merely overlook the basic relation between production and prices, they also seem to shut their eyes to certain broad facts which ought to have convinced them otherwise. Since the end of the war till June, 1948, the Economic Adviser's price index has gone up by 56 p.c. whereas Notes in Circulation and Bank Deposits have increased by 36 and 34·7 p.c. respectively. Thus prices—even though controlled for most of the period—have increased more considerably than cash balances. This, if anything, must be an indication that cash turnover has increased during the period. To talk of a fall in 'effective circulation of money' in the face of these facts is absurd, if not mischievous.

[3] I have discussed this matter at fuller length in a paper printed for private circulation (Inflation in India—Theoretical Analysis Economic Convention, 1948, Khoj Parishad, Calcutta).

There has been no doubt some decline in production in certain directions in the post-war years. The 'Capital' Index shows a decline in industrial activity from 120·7 in 1944-45 to 105·8 in April, 1948. But to say that this is the *cause* of high prices would be grossly to misjudge the process of price formation. It would be just a crude and mechanical application of the old Quantity Equation which conceals the more vital and organic connection between prices and production.[1] For, if we rule out harvest failure and similar exogenous phenomena, the effect of falling output turns out to be just the opposite of what the so-called Quantity Equation would lead us to suppose. A fall in output, in so far as it is accompanied by a fall in the volume of employment, should rather result in lower money income and in lower prices. Indeed, in our present context, it is money that has been the initiating factor in the causal process. Decreased saving and increased money income have caused prices to rise and *yet* output has remained low—this is the situation. The significant query, therefore, is rather why output has failed to respond to rising prices, why the price boom has not been accompanied by an output and employment boom. This, no doubt, is a sort of an anomaly which needs explanation.

Reference is often made in this connection to labour strikes which have been a feature of our post-war economy and this of course fits in with the 'scarcity' explanation of inflation. You pay wages all right but labour is not effectively employed during the strike period. Expenditure is thus kept up while output lags behind. I would argue, however, that the waste on this account must not be exaggerated nor must the warrant for these strikes be glibly over-ruled, for, are not these strikes themselves the inevitable result of the inflationary rise in the cost of living? There are indeed other more important factors to explain the fall in output.

Firstly, there must have been some diminution in the income-getting power of the country on account of the depletion of capital resources during the war years. During the war we had surely full employment in any understandable sense of the term, and, in the

[1] A very glaring example of this kind of fallacy is to be found in a recent article by no less an authority on public affairs than Arthur Moore (see his 'Some Aspects of Inflation, *Capital*, September 16, 1948). "Inflation," says Arthur Moore, "does not mean that there is too much money about; it means that there are too few goods about. . . . . The basic remedy for inflation . . is increased *consumption* of stable commodities." (My italics).

face of rising money rates of wages, it is difficult to believe that there has been much of a reversal in the post-war years except perhaps to the extent warranted by the creation of specificity of labour.[1] Now, even the same amount of labour with diminished capital must yield smaller output. It is difficult to estimate the degree of internal capital depletion that has taken place during the war and the extent to which it has been replenished in the post-war years. But the general presumption seems to be justified that adequate replacement has not been done. This is due partly to the difficulty of importing capital goods from abroad and partly also perhaps to the uncertainties of the market. In the circumstances an increase in the technical resistance to output seems to be inevitable. We often hear of transport bottlenecks, and of course they have been serious. Is not the problem of machinery bottlenecks at least equally serious, too?

Secondly, specificity of labour is one of the factors that might have kept down employment and output in spite of rising prices. Employable labour may be there in the market, but it is not sufficiently mobile or is not suited to just those industries that are having the stimulus, unemployment and rising prices may very well go together. In a short period which experiences fundamental structural disorganisation, unemployment is surely consistent with rising prices. Post-war transition should in general be characterised by such structural disorganisation. In the Indian context, however, since, as I think, the production structure was not affected by the war to any substantial extent, transitional unemployment would not perhaps be at all serious. But partition has upset our calculations. The inter-Dominion movements of population that have followed it have introduced into the economic system a degree of specificity whose importance cannot altogether be neglected. The outgoers have left gaps which have not been filled in by the incomers. The latter have not yet been fitted into our economy, and it may take some time before they are. The refugees—at any rate, a large part of them—are consuming agents, not producing agents yet.

Above all, thirdly, there is that obnoxious legacy of war-time controls—an unusually large degree of market imperfection and rigidity—whose share of responsibility in keeping down employment and output must be taken serious account of. Indeed,

[1] See below.

in my judgment, the almost ubiquitous monopoly practices which controls and the license system have brought in are, both qualitatively and quantitatively, the most significant of the restrictive forces operating in our economy today.

If the above analysis is correct, then it appears that there is scope for an increase of production, although by any reasonable calculation it seems unlikely that it should be anything very large when account is taken of the hard fact that the technical equipment is in the short period practically fixed. Quite apart, however, from the magnitude of the potentiality of output, will an increase in employment and output at all solve our problem of inflation? This is rather the more significant question in the present context. On the lines of the reasoning applied previously to the case of falling output, we may at once see that the reaction is more likely than not to be just the other way about. Except in so far as there exists excess capacity in plants and machinery, increase in employment results in diminishing returns, so that with a given money wage rate, additional output can be secured only at a higher money cost of production. And, of course, a rise in money cost can hardly be accompanied by lower prices! To put the matter in a slightly different way: An increase in employment and output will be accompanied by an increase in money income by way of payments to factors used; but on account of the operation of diminishing returns, the increase in output will not be commensurate with the increase in money income, Hence, unless the rate of saving increases in the meanwhile, additional expenditure will still press on output and prices will have a tendency to rise up. Full employment must certainly be an objective of economic policy under any circumstances. But no economist in his senses will ever say that full employment measures will by themselves lower prices. On the contrary, in our present context, since the ruling real wage rate, in spite of rising money wage rate, is about the minimum conceivable, and since, therefore, we are already in a state of true inflation, a removal of bottlenecks—no doubt highly desirable by itself—will inevitably lead not only to rising prices but also to rising money wage rates.

With the existing money wage rates—and, of course, a cut in wages is not a practicable proposition in the present state of things—the only way how an increase in output could be made compatible with a fall in prices is by *raising the productivity of labour.* If

labour becomes more productive, then surely other things remaining the same, the unit cost of output diminishes and prices do have a tendency to fall. I shall not be surprised if this is what turns out in the ultimate analysis to be at the back of the mind of those who are emphasising the output aspect. Even then they should remember that increase in the productivity of labour involves larger and better employment of capital. It implies not merely an increase in the effectiveness of labour, it also implies an increase in the efficiency of labour. All these, however, are a long period affair and, important as they are vitally for our economy. they must be considered independently of our immediate problem of inflation and must not be confused with it.

Inflation as such is a monetary phenomenon. If it is to be tackled, it must be tackled by monetary measures,—measures relating to investment and saving. As an incentive to production, uncertainty of the market must be removed and competitive forces must be released as far as possible. But as a preliminary to any background measure of this kind, the market must be relieved of the redundant currency and of the possibility of a wayward movement of prices such as we are having today.

INDIA AND THE DOLLAR PROBLEM

BY

Lanka Sundaram

The problem of India's dollar requirements is bound to assume added importance with the passage of time, for a variety of reasons, not the least important of which is the growing need of the country to obtain sufficient hard currency to buy capital goods, etc., in the non-sterling area of the world. This is a problem, however, which has been very sadly neglected in this country, both in official and non-official circles, and it is thus very necessary that an examination is made of it in all its aspects.

By a series of notifications issued on July 11, 1940, September 28,1940 and November 23, 1940 [Rule 92(2) of the Defence of India Rules], the dollar resources of Indian nationals were frozen and taken hold of by Government of India as one of the steps needed for the prosecution of the War. Under a Finance Department notification of March 10, 1941, the Government of India took over American securities held by Indians "for the purpose of strengthening its financial position" and "to transfer to itself certain foreign securities." The position was particularly difficult before the establishment of Lend-Lease by the late President Roosevelt, and Britain was obliged to lay hands upon the dollar resources of every country in the Empire and create the now infamous Empire Dollar Pool. Time and again, the Central Legislature, during the recent War period, demanded the withdrawal of India from the Empire Dollar Pool and the non-freezing of India's dollar resources, but with scant success.

As if stung with remorse, Sir Jeremy Raisman announced the allocation of 20,000,000 dollars in 1944 and a like amount in 1945, ostensibly to serve the needs of India for dollars to enable her campaign of industrialisation to take shape. In 1946, Sir Arch.. ald Rowlands allotted 40,000,000 dollars for the same purpose. It must, however, be remembered that allocation of dollars between 1944 and 1946 cid not necessarily mean actual access to and utilisation of the same, either for the purpose of meeting the day-to-day requirements of the industry and commerce during the years concerned. The operation of controls in India, *viz.* grant of priorities, import licences, allocation

of freights, etc., was such that Sir Archibald Rowlands was compelled to admit in the Budget Session, 1946, of the Central Assembly that these dollar allocations were not fully utilised by nationals of this country. It was almost suggested that Indian industrialists were unwilling and enable to utilise allocations of dollar resources. But as one who has had considerable opportunity of studying this question firsthand, I am in a position to state that this suggestion was a canard which must be exploded without any mercy.

Actually, the boot was on the other foot. Indian industry was groaning under the incubus of lack of opportunities for replenishment of machinery and parts. Even the visit of the Indian Industrialists' Mission to the U. K. and the U. S. A. in 1945 did not give to this country the much needed access to the capital goods markets of these two Western nations, even though such markets were sellers' markets and the Indian industrialists concerned were willing to pay, from out of the meagre allotment of dollars for the year 1944 to 1946, for such of the equipment which was imperatively needed by them to enable the industries to carry on. I make bold to say that what little dollar allotment was grudgingly made during these three years was rendered nugatory, in so far as access by Indian *entrepreneurs* to goods in the U. S. A., and even in countries like Switzerland, etc., was denied through the operation of controls by the Government of India at the behest of the British Government. It will, thus, be seen how the problem of dollars for this country was rendered extremely difficult b the British Government, and its factotum, the executive government in India, during all the years of the World War II, and even during the early months after the cessation of international hostilities.

Information was consistently denied by the Government of India about India's dollar resources, which were compulsorily brought into the Empire Dollar Pool since the outbreak of the Second World War up to date. Even Sir Ardeshir Dalal, when he was the Planning Member, did not fulfil his pledge for giving information on this vital question, which was part of his responsibility to the country, for he was face to face with the problem, particularly after his talks in the U. K. and U. S. A. at the time of the Indian Industrialists' Mission's visit to those two countries, to find out exactly what dollar resources India had, or has, to plan out her industrialisation through purchases of machinery and other equipment in non-sterling countries.

Such of the estimates which are extant in this country about India's contributions to the Empire Dollar Pool were available through American sources and through non-official estimates in this country. *COMMERCE & INDUSTRY* of New Delhi estimated the accrual of India's dollar resources at anything between 800,000,000 to 1,000,000,000 dollars (November 14, 1945). This estimate was based upon the following indices:

1. The requisition of dollar securities and balances held by Indians under Requisition of Dollar Securities and Balances Order of the Government of India sometime in 1940	30,000,000 dollars.
2. India's net favourable balances of trade with U. S. A. during the war period up to March, 1945	180,000,000 "
3. Expenditure of U. S. A. in India (November 26, 1945)	564,000,000 "
	774,000,000 dollars.

These figures obviously relate to a period earlier than the cessation of hostilities in the Far East, and the backwash of Lease-Lend and Reverse Lease-Lend transactions, taken together with similar other commitments of Britain in the U. S. A., lead one to the conclusion that India's dollar resources had actually shot over the 1,000,000,000 dollar mark. Representative Emmanuel Celler repeatedly stated that this was the case, and this estimate was confirmed by a statement of the U. S. Department of Commerce that 25 per cent. of the Sterling accruing to India in London was through the transfer of India's dollars to the Empire Dollar Pool, and this equation also lends weight to our estimate.

The following table indicates the trade position between U.S.A. and India during the seven War years:

(In crores of rupees)

Year.	Exports to the U. S A. from India.	Imports from the U. S. A. into India.	Balances of Trade.
1938-39 ...	14 3	9.8	+4.5
1939-40 ...	27.2	14.9	+12.3
1940-41 ...	31.9	27.0	+ 4 9
1941-42 ...	46 4	34.6	+11.8
1942-43 ...	27.8	19.1	+ 8.7
1943-44 ...	40 3	18.4	+21.9
1944-45 ...	44.8	50 5	− 5.7
	Balance in favour of India		+58.4

What has happened to these 1 000,000,000 dollars owing to India from the Empire Dollar Pool? The answer to this stupendous question is a very simple one. Worthless sterling came to be piled up in India's account in London, and India's share in the Empire Dollar Pool was eaten up de iberately by Britain. Mr. Harry White, Assistant Secretary to the U. S. Treasury, testified to a secret session of the U. S. Senate Banking Commission that, Britain at one time held 3,500,000.000 dollars in gold and securities on deposit in U.S.A., and yet India's dollars were eaten up without any compunction at all. It is known that during the years 1943 and 1944 Britain was able to redeem some 200,000,000 dollars, or possibly more than this conservative estimate, from out of the 425,000,000 dollars pledged as collateral in 1941 by the British Reconstruction Finance Corporation with the U. S. A. This process of "renewal" of Britain's economy was only made possible through a most unceremonious and pitiless denial to India and other freedom-less countries of the British Empire group of their legitimate dues.

While India, even after the visit of the Indian Industrialists' Mission to the U. K. and the U. S. A. in 1945, failed to obtain her dollars for legitimate use, American opinion got hardened from that day against the existence in operation of a strong sterling *bloc*, which they considered to be inimical to their own trade interests. This was the reason why Senator Brewster threatened the creation of Dollar *bloc* for the U. S. A. if Britain refused to liquidate her sterling obligation to countries like India. One had thought that the grant, early in 1946, of a low-priced 50-year loan of 4,400,000,000 dollars to Britain by the U. S. A. would secure a partial grant to this country of dollars through the conversion of accumulated sterling in London. This has not happened so far. On the contrary, the Lend-Lease overall agreement between India and the U. S. A., which was initiated by Sir Arthur Waugh on behalf of India and Mr. Dean Acheson, Acting U. S. Secretary of State, on May 16, 1946, had the effect of completely wiping out the direct Indo-U. S. accounts relating to Lend-Lease and Reverse Lend-Lease. The result was that India was left to the tender mercies of Britain in respect of her dollar requirements and resources, and even the resignation of Mr. K. C. Mahindra, Head of the Indian Supply Mission in Washington, in 1945, as a protest against the obstructions thrown across his path for dollar purchases, did not create the requisite impression upon the British People.

A glance at the over-all trade figures of India will demonstrate the manner in which India's foreign trade was stifled. In 1944-46 India's favourable balance of trade was Rs. 27 crores (total exports 228 crores : total imports Rs. 201 crores). This meagre favourable balance compares to a balance of Rs. 92 crores in 1943-44 and Rs. 84 crores in 1942-43. It is a curiosity of economics as how in 1944-45 our favourable trade balance could be reduced to such low depths compared to the preceding two financial years. If we compare itemwise the export and import figures, we will find the following results :

	Rs.	crores
Total exports from India to U. K. and Empire countries	138	,,
Total imports into India from U. K. and Empire countries	78	,,
Total exports from India to non-Empire countries	73	,,
Total imports into India from non-Empire countries	125	,,

For the first time in 1944-45 our trading with non-Empire countries yield a tremendous deficit in our balance of trade. As against this, exports to the U. K. and Empire group shot up in a remarkable manner indeed, compared to the total import from the same into this country. The moral of this equation is clear. The existence and operations of the Empire Dollar Pool militated against the natural fanning out of India's overseas trade, and the establishment of profitable trade relations with non-Empire countries, without which our national economy cannot be sustained in all its aspects, either today or tomorrow. It is established that India's favourable balance of trade with the U. S. A. was declining in recent years. On the other hand, Representative Emmanuel Celler (July 28, 1945) declared that American exporters were entitled to "yell like stuck pigs" against the artificial barriers to U. S. A. trade with India owing to the existence of the Empire Dollars Pool. In contrast to this picturesque outburst of an American politician, a spokesman of the U. S. A. Government (July 20, 1945) admitted that India had suffered in her trade relations with the U. S. A. owing to the existence of the Empire Dollar Pool. It is clear that in the overall trade relations between India and U. S. A., we have come off very badly indeed, and that Britain had reaped a very rich harvest in her approach to problems of our national economy, pushing us further down the ladder of industrial and commercial progress.

It is important for India's economic progress that the problem of sterling balances is suitably solved, keeping in full view our economic needs and requirements. The loan which U. S. A. granted to Britain sometime back sets a precedent of great significance to us in this country. I do not see any reason why the Government in the U. S. A. cannot give the Government of India a direct loan of, say, 1,000,000,000 dollars with a price and service period which are not dissimilar to those granted to Britain. The collateral for this loan would necessarily be India's sterling credits in London, *plus* a guarantee by Britain that the American loan to India would be amortised and paid off from our sterling credits. I do not see any difficulty for Britain to pay off 20,000,000 dollars, *plus* interest, every year, by nibbling at our sterling credits. Naturally, this would be a direct loan from the U. S. A. to India, with Britain as guarantor and ultimate debtor. In other words, Britain's indebtedness to India would be converted into her additional indebtedness to the U. S. A. Something like this transfer of indebtedness is vitally necessary both

SCHEDULED BANKS (*in lakhs of rupees.*)

Year	Demand & Time Liabilities (*a*)	Bills Discounted (b)	% of (*b*) to (*a*)
1935-36 ...	22,056	356	1.6
1938-39 ...	23,783	486	2.04
1939-40 ...	24,568	525	2.1
1940-41 ...	26,884	384	1.05
1941-42 ...	31,896	493	1.5
1942-43 ...	41,049	218	.5
1943-44 ...	59,941	552	.9
1944-45 ...	77,892	1,116	1.4

liabilities of the scheduled banks. For a country that aspires to launch upon gigantic schemes of economic development and regeneration, nothing can be more alarming, disappointing and pitiable than this. Every intelligent industrialist and trader must concede that the institution of organized Bill Markets at places like Calcutta, Bombay and Cawnpore should be considered as the main plank of planned development. This is more so because until there is an organized Bill Market, as there is one for stocks and shares, the Indian banks are not likely to take any great interest in this matter.

(*d*) *Agricultural Credit Bills*

The need for linking up rural credit with the urban money market was well appreciated and improvised in the Reserve Bank Act, 1935. Thus, by section 17 (2) (b) of the Act, the Reserve Bank is authorised to purchase, sell or re-discount bills that satisfy the conditions set out below:

(i) That the bills are drawn and payable in India.

(ii) That they bear at least two good signatures, one of which is that of a scheduled bank or a provincial bank.

(iii) That they are drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops.

(iv) That they mature within nine months from the date of purchase or rediscount by the Reserve Bank exclusive of days of grace.

Under the above provisions the Reserve Bank of India can undertake rediscounting of agricultural bills bearing endorsement of a scheduled bank. But in the existing conditions it has not been possible to afford adequate facilities for agricultural credit; in fact, nothing much could be effected beyond offering some advances to the co-operative organisations through the agency of provincial co-operative banks, and even now the bulk of rural credit is supplied by individual money-lenders. The Reserve Bank, it will be agreed, cannot be expected to participate on any broad scale until the rural credit system is properly regulated and conforms to the prescribed minimum conditions.

Here it needs be fully appraised that any planned improvement of agriculture as envisioned in post-war schemes will necessitate vast influx of capital into the countryside. The entire system of rural credit must be re-organised, widened and placed on a new footing. In substance, the whole state of affairs must be properly conditioned so as to enable the joint-stock banks along with the central bank to finance on a wider basis agricultural production and marketing. In this connection, it may, however, be suggested that the first step to such re-conditioning would be the establishment of licensed warehouses at the principal agricultural centres. Construction and maintenance of these warehouses can conveniently be undertaken by the provincial Governments through the co-ordinated functions of the Agriculture and the Co-operative Departments. If this is done, the agricultural bills, supported by receipts issued by the government controlled warehouses, may be readily accepted by scheduled banks. Such bills will then be re-discountable in the proposed Bill Market or at the counter of the Reserve Bank.

(e) *Hundis*

Another form of exchange bill which enjoys wide currency in the Calcutta market consists of *hundis* drawn by parties financed by

indigenous shroffs and accepted by the latter. The indigenous bankers or shroffs have by arrangement limits fixed for them by the Imperial Bank and other big commercial banks, and the *hundis* drawn and accepted on the strength of this cover are freely discounted by the Imperial Bank and other top-ranking banks. Some of the exchange banks as well take interest in the discounting of *hundis*. But, in fact, such *hundis* do not always arise out of genuine trade transactions and are sometimes used as mere substitutes of cash credits or outright loans. This system is neither safe nor congenial. It may, however, be hoped that with the organization of a Bill Market and the increased practice of drawing trade bills, the *hundi* system will automatically become unpopular, to be resorted to only in case of extreme emergency.

In this connection it may be noted that the "Imperial Bank is becoming more and more censorious in the matter of *hundis*. It is of opinion that *hundis* are becoming very risky documents. One of the Governors of the Imperial Bank is of opinion that *hundi* brokers generally are not of a reliable character and they have the knack of disappearing in a monetary crisis. Any bank which wishes to discount largely these *hundis* should take security from these brokers which should be confiscated if any loss arises out of these transactions. Endorsees of these *hundis* must also be of a solvent character. All these precautions are essential to check kite-flying by men of doubtful standing in the money market."[3]

Other Conditions

The organization of a discount-market in bills, as envisaged here, will require fulfilment of certain other conditions. Trade bills to be eligible for discount in the open market must be covered by acceptable guarantees. In the first place, these bills must be accepted by the parties on whom they are drawn or must be guaranteed on their behalf by their bankers. Secondly, the bills should be drawn for a definite currency and must have a specific date of maturity. Regulation of commercial practices with a view to satisfying these conditions should not be very difficult. Supply bills drawn upon Government departments, municipalities, railways, other semi-public bodies and large commercial institutions, can be given a definite maturity period not exceeding 90 days by mutual agreement and be accepted by the drawee or his banker, which must be of the status of

[3] B. R. Rau, *Persent-day Banking in India.*

a scheduled bank. As to other commercial bills, they should have similarly a definite period of maturity not exceeding 90 days and must be accepted by the party they are drawn upon, and further they must bear the signature of a scheduled bank as a collateral guarantee. Agricultural bills should also be endorsed in the same way and guaranteed either by the provincial co-operative bank or any scheduled bank. Regarding foreign exchange bills, there will not be any great difficulty. It is, however, rightly apprehended that such commercial practices are not likely to come into vogue without Government intervention and it is high time that suitable legislation in the matter is adopted.

Rediscounting facilities offered by the Reserve Bank of India as per provisions laid down in the Act should also be properly attended to. It seems to be a common grievance that re-discounting facilities now available at the Reserve Bank are too meagre and the clause of "approved" bills and securities acceptable for such re-discounting are often interpreted in a rather unresponsive manner. But a close scrutiny of facts will reveal that the Reserve Bank cannot go very far until the general circumstances improve. It needs here be fully appreciated that the Central Bank as the apex institution guiding and controlling the entire banking system of the country cannot afford to be unduly liberal in the matter of granting loans and advances. In fact, re-discounting of bills at the Reserve Bank's counter should be the last resort and in no circumstances should it be encouraged as a part of the common practice. Moreover, with the institution of an organized Bill Market the occasions for such re-discounting will become more uncommon. Nonetheless, the very fact of their re-discountability at the Reserve Bank will render them into readily acceptable instruments of the money market. On the other hand, it is quite abvious that the Reserve Bank, because of its unique position as such, cannot absolve itself of heavy responsibilities, if an organized Bill Market is to be successfully set up. As the Central Bank it is the pivot of the entire money-market, and in this matter too the public would legitimately demand of its authorities to take up the initiative. During the past few years, the affairs of the Reserve Bank have not been always free from fault and not unoften it has failed to rise to meet the country's requirements. It is, therefore, demanded that the authorities should no longer shelter themselves in unresponsive passivity and should take bold steps to organise the money-market on lines suited to the situation.

Reserve Bank are likely to extend to them, they can work with full confidence as necessary components of Indian economic life.

On account of legislative protection which is being designed to safeguard money entrusted to banks, depositors are bound to develop greater degree of confidence in the banks of the country. This must further stimulate progress of Indian banks. If any further assurance to depositors were necessary the country, can introduce insurance on deposits as has been done in the United States of America.

Bankers in India are often accused that they do not help in providing industrial finance for the country's growing industrial needs. The word "industrial finance" connotes many types of credits—one, long-term credit meant to supply capital needs of industry and the other short-term credit calculated to supplement their working capital. Banks in India today are mostly of the type known as "commercial banks", which specialize in taking short-term money, and consequently it is beyond their scope to cater for anything other than short-term credit needs of the country. It is true that commercial banks in some countries have been meeting long-term credit needs of their people but we must remember that Indian banks in the past have had to depend only on themselves for help and succour in times of need and they could not, without peril to their existence, violate the basic principles associated with their working. But I have every hope that with the changing times, India will have specialized banks dealing with long-term industrial credit needs of the country ; and even some of the existing banks may combine to find such institutions. I understand that Government of India is actively considering to establish some such institution.

India's commercial intercourse with the outside world is expected to increase more and more. Increasing share in such business would be handled by the people of the countty. The necessary consequence of such a development would be participation by Indian banks to an ever increasing degree in the foreign exchange operations of India. To the uninitiated and uninformed, foreign exchange business has been represented to be risky and dangerous business. No doubt it requires certain amount of technical ability for its successful operation, but that is a pre-requisite of every walk of life. But with proper training and guidance, India should produce exchange traders as capable and efficient as any country. Even today some of

our Indian bankers are working so ably and safely in foreign countries that they have won admiration of their competitors and foreign bankers.

Indian banking is entering an age of great opportunity and usefulness. It can plan development with fullest confidence. But like every public activity it must not exploit economic needs of the nation for its own aggrandisement—it must remain a handmaid of business and a servant of the people.

FOREIGN BANKS IN INDIA

BY

Manu Subedar

Foreign banks occupy an important place in the financial mechanism of this country and are most important in the financing of the foreign trade of India. They are known in this particular sphere as exchange banks; but the name of exchange bank is a misnomer. They are not mere exchange banks only; they have got branches in the interior; and I have never been able to understand a country which would permit a foreign bank not only to come in at the ports but to penetrate right inside and establish branches and to do internal banking business for the people in this country. These institutions are big and powerful—the most powerful among them being the Lloyds Bank, which is one of the biggest banks in the United Kingdom; with their experience and with their personnel and with their superior power, they always got the ear of the Government of India during the British Period. In every matter they are competitors who have always given trouble to Indian banks. It is well known—I am writting about what happened twenty-five years ago fortunately, because now the Indian banks are strong enough to defy these exchange banks—that the spring of all the rumours which caused runs on the Central Bank of India and even on the Bank of India at one time—two of the biggest Indian banks today—was from the exchange banks. These banks have prevented the growth of the rupee bill market in India. Ours is the only unfortunate country in the world in which everybody who sells to us sells in pounds, everybody who buys from us buys in pounds—in other words, there are no rupee bills. If there are no rupee bills, there is no rupee bill discount market and therefore our money market is entirely undeveloped. This great injustice to this country from the continued operation of the exchange banks in the last thirty years is one which will be remembered in future and which it was attempted by the Central Banking Enquiry Committee to cure—but in which I am sorry to write the Reserve Bank has completely failed to realise its obligation. These British banks have helped British shipping and British insurance companies. They have made it impossible for shippers to use Indian companies; they have made

difficulties with regard to shippers and to borrowers to use the services of Indian insurance companies, to the disadvantage of this country and that is one of our grievances. They do not always keep their funds which they raise in India in this country; it was notorious in fact at one time that they took enormous amounts of cheap deposits from this country and took it outside this country, to the Far East, and earned very much higher rates of interest that were prevailing there.

When these foreign banks come here, they do not bring much money or material to this country: they raise deposits in this country, deposits belonging to the Indian people. These deposits are placed there at a cheap rate and they are lent out to European firms at a cheap rate—European firms who are competing against our traders; and by this competition not merely our bankers suffered; it was not merely the Indian banks who were the victims of this unfair competition which they were enabled to inflict by means of Indian money; it was the Indian traders and the Indian businessmen who also suffered: the Indian businessman when he went to his bank had to borrow at a heavier rate of interest because the Indian bank in its turn had to pay a higher rate on deposits. The English businessman when he went to the exchange bank was able to borrow one or two per cent cheaper and lower. This perpetual favoured position with regard to the money rates in favour of foreign business in India has been a feature of the life of this country for the last thirty years, and this is the thing which we must destroy. We have the precedent of no less a country than the richest country in the world, namely, United States of America, which is prohibiting any foreign bank from establishing branches in America and borrowing there. You can have a branch in America and take your own money there or lend; but you cannot have a branch in America and raise deposits: they are prohibited even from becoming trustees. So strict is the vigilance of the American people that not one dollar of American money will be used by foreigners against American trade in America itself. This is the unfortunate position in which this country is. This was the major point of difference between my colleagues and myself on the Central Banking Enquiry Committee. There was no other major difference. Were they or were they not for prohibiting foreign banks (including British Banks) from raising deposits in this country? If as I wanted only banks registered in

India can raise deposits in this country, then there was no question about licensing foreign banks, because the registration business would have brought every institution under the operation of all the laws which applied to banks, and there was no need to license the foreign bank who could lend but not borrow in India. But this could not be done while the discriminating sections 111 to 121 of the Government of India Act existed. Therefore the next best thing which was unanimously reported by the Central Banking Enquiry Committee, presided over by the only Indian who had held, though for a very short time, the office of the Finance Member, it is surprising that the Government of India should have rejected, and rejected without any explanation, the unanimous recommendation to them of a license applicable to all banks.

Then there are other foreign banks also, banks from other countries, such as Portuguese ,Japanese, French and American: and indeed the reciprocity clause which was included in the proposed Banking Companies Bill was very clever though unsatisfactory.

Indian banks find it beyond them to start exchange banks because of unfair competition of foreign compeers and the hegemony of foreign banking, shipping and insurance interests. At the time of the establishment of the Reserve Bank of India, it was expected of the Imperial Bank that they would function as an exchange bank. It is said that they have got an office in London; but I do not know whether they have launched themselves out sufficiently in the exchange field; but if they have not, then certainly they have belied one of the greatest expecations which was made of them at the time of the Central Banking Committee.

BANKING FRAUDS IN INDIA

BY

N. V. Sonalkar

The senior bank officers are required to be a peculiar blend of a solidier, a scholar, a statesman, a salesman, an administrator and a saint. It is difficult and slow process to pick up men who will after requisite, traditional and long training come up to the expectations Lack of prospects of rising to higher positions had prevented the educated and able type of young men from going in for banking service as a career—a few exceptionally gifted persons still did rise from the lowest ranks to high positions. The branch expansion in India was held up for want of trained staff but the failure of the Alliance Bank and the amalgamation of the Tata Industrial Bank gave a large and experienced staff to the Imperial Bank of India which took over the Alliance Bank, and to the Central Bank of India with which the Tata Industrial Bank was amalgamated. This made expansion of branch banking easier by increasing their staff of experienced hands who could relieve competent officers and train other men. Both the Banks also began taking qualified young men to be trained for responsible positions and more and more persons of the right type were attracted towards the banking profession.

Banking did not attain its present unique position and banks did not come to connote honesty, vigilence, service, confidence and impartial advice, merely because rich and outstanding personages adorned the Boards of banking companies. The prestige and reputation was built up by those easily satisfied middle class gentlemen who valued their reputations more than money and lived up to certain high standard of honesty, probity, impartiality, usefulness, alertness and study which they set for themselves as absolutely essential for inspiring the confidence of the public in banks' utility and reliability.

The ethics of conduct and ideals of efficiency have after long experience crystallized into such definite rules that the slightest deviation from them results in loss of reputation, money or business.

Any act of commission or omission which causes loss to any bank is a fraud practised upon it consciously or unconsciously. The frauds on banks can be classified as follows :

1. By an outsider without the help of an employee of the bank.
2. By an outsider with the help of an employee of the bank.
3. By an employee.
4. By a person in authority in the bank.
5. The client taking advantage of the mistake or omission of the bank.
6. Lack of knowledge on the part of the management.
7. Failure of the Manager to be alert.
8. Prolonged illness.

It is difficult to estimate the magnitude of the aggregate loss suffered by banks in any one country during a year, how much of it is borne by the insurance companies, how many lives are ruined, what public money is wasted in investigations and prosecutions. In Calcutta alone hardly a year passes without reports of a fraud involving over a lakh of rupees. The alleged swindle of a number of banks to the extent of Rs. 40 lakh by one Ghosh, who is reported to have given bogus bills on the Supply Department, is perhaps the biggest fraud by one individual. It is not known what amount will the banks have to write off as bad debts. The Bank of Baroda and the Bhowanipore Banking Corporation cases appeared to cover eight to ten lacs of rupees each. Privy Council having decided in favour of the Bank of Baroda, some part of the loss fell on other banks.

Most of the banks have been devoting some attention to "plugging the locks" by finding out how frauds were committed, and have been altering or devising system of checks and balances. But if frauds are to be prevented, it is more important, and particularly so at this juncture, to study not how frauds are committed but *why* frauds are committed.

Just before the outbreak of the war which has ended, the banks in India had gathered a nucleous of a staff which had attained

just that degree of proficiency which would encourage the management to try them in responsible positions. But India had in recent years a remarkable crop of new banks which were bent on opening as many offices as possible. Unfortunately this phenomenon occurred exactly at the time when the older banks were also compelled by pressure of circumstances to expand their activities to a larger number of trade centres. Naturally both the old and the new banks had to draw on the limited supply of trained hands and as a result there is hardly any banking office in India, which can say that it has sufficient experienced staff. The new banks are probably worse off in this respect because they have got a heterogenous collection drawn from different institutions and their own routine is not yet settled. It is true that the new banks have paid higher salaries to attract experienced men, but they have not succeeded in getting as many men as they require. The older banks have been compelled to induce their men to stay. They are also feeling keenly the strain of the drain on their personnel and have had to promote men to such higher positions as they would never have dreamt of reaching in the higher levels of the hierarchy.

In the making of a banker, practice counts more than theory and the banks which have pushed ahead with the opening of branches with men who have not gone through the traditional long period of apprenticeship, have offended against some inexorable principles of sound banking. On account of the dearth of experienced staff, they have got to tolerate the inefficient persons, thus promoting laxity and putting greater strain on the smaller proportion of experienced hands thus making the banks more vulnerable exactly at the time when they are most exposed to frauds.

The periods of inactivity in production and employment which generally follow long wars are known to produce crime waves. This is because during the continuance of hostilities anybody willing to work generally finds employment; many people earn more than they deserve and come to adopt higher standards of living. When the sources of earning easy money dry up and unemployment increases, many do not like to return to their pre-war way of honest living and resort to fraud to replenish their fast emptying coffers.

Comparatively, India has been immune from deliberate frauds practised by clever and daring forgers and organized gangs of crooks but recent reports of frauds on a number of banks show that the new type of criminal equipped with scientific knowledge and backed by

clever unscrupulous artisans is stalking boldly about victimising the placid unsuspecting bank men.

Very few criminals care to disclose all the circumstances that led them into committing the defalcations. It is, therefore, difficult to analyse how exactly the criminal's mind works under a given set of circumstances. But broad factors contributing to the downfall of men, which emerge from the study of reported frauds, are worth noting.

Necessity coupled with opportunity accounts for the largest number. Necessity for money may arise either on account of unforeseen expenditure due to illness in the family or other social circumstances or because the man has contracted vices or has taken to gambling. Banks, therefore, see that their employees are adequately paid and are helped in periods of difficulties brought about by circumstances over which they had no control. If banks only watch the conduct of their employees, they would at once detect how one was living beyond his means or getting into financial difficulties. Such indications were not wanting in most of the cases where employees have cheated banks.

No employee starts helping himself to funds by fraud with a view to cheat the bank outright. He justifies his conduct in the beginning by believing that he is only borrowing money and is perhaps all the time anxious to return the money. In spite of the inclination of the employee to help himself, he would be helpless if the system of checks and balances in a bank were properly drawn up and kept efficient and uptodate. It is only oppurtunity that ultimately drives one with poor moral stamina into actually committing a fraud. Banks must, therefore, get their systems overhauled by experienced and competent officers and make them fraud-proof. They should have regulations insisting on the highest standards of morality and behaviour and must encourage those who maintain such standards. They must prohibit the staff from indulging in speculation or gambling or moving in bad company.

The senior officers of the bank must also watch the behaviour of their staff with clients and they must carefully scrutinise the work and dealings of those members of the staff who show special friendship with particular clients. The bank authorities themselves must see that none of their transactions savour of sharp practices

because once the staff gets to know of these, quite a few of them would be led to copy the example in other directions.

A little carefulness generally leads to detection of frauds. Responsible bank officers must, therefore, never accept explanations lightly about the irregularities without thoroughly going through all the entries. If they carefully investigate how and why the irregularities occurred, they will very often discover a fraud.

The safety of the bank's funds lies almost entirely in the hands of the staff. The bankers can assure themselves of the best protection against frauds if they select their staff after proper scrutiny about their antecedents and the family history and offer them security of service and take personal interest in their welfare, encouraging them for all good work and standing by them in times of their difficulties. It will be difficult for an outsider to practise fraud on a bank if the employees of the bank are honest, experienced and alert.

Every fraud, however cleverly practised, carries a warning which an experienced banker catches almost by intuition. There is always some irregularity which if noticed and pursued can always defeat the designs of the cleverest crook. There may be something suspicious in the behaviour of the man or in the hurrying up of the staff or in his trying to be funny. It may be found in the unusual nature of the transaction or in the peculiar characteristics of the transactions of a recently opened account or a mixture of more than one of these. Very few experienced officers can deny that they had somehow felt that there was something wrong with the whole thing, when they passed orders for payment on the strength of a document which was forged or fraudulent.

From the recent reports it appears that the knowledge of the chemicals, which can easily erase names, words and figures written with ordinary inks, is increasing and more and more banks have been victimised particularly by erasing the lines which are usually drawn to make it crossed or payable to order. In India before the law was recently amended, a cheque originally made payable to bearer, could be made payable to order of a subsequent payee if it was endorsed by any of the holders so as to make it payable to a person or his order. Since the amendment of the law, a cheque drawn payable to bearer always remains payable to bearer; and, banks must not accept, in their own interest, mere drawing of a line as making the cheque

payable to order. As it is a meterial alteration, it should bear the full signature of the drawer.

In India the laws affecting bankers differ from province to province. Many a bank has lost in the courts or paid heavy penalties because its documents were not properly drawn up. It is in the interest of bankers to call for a conference for discussing the various central and provincial laws that affect the banks and move the proper authorities for removing the uncertainties regarding interpretations of certain sections of laws as they stand at present and for removing the disabilities like heavy stamp duties on instruments of hypothecation or pledge which come in the way of their extending accommodation to the traders with minimum and reasonable incidental costs.

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